ADMINISTRATION AND OPERATIONS OF THE PENSION BENEFIT GUARANTY CORPORATION

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

APRIL 20, 1993

Serial 103–25

Printed for the use of the Committee on Ways and Means

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ADMINISTRATION AND OPERATIONS OF THE PENSION BENEFIT GUARANTY CORPORATION

TUESDAY, APRIL 20, 1993.

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:34 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
TUESDAY, APRIL 13, 1993

PRESS RELEASE #7
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1135 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A PUBLIC HEARING TO REVIEW THE
ADMINISTRATION AND OPERATIONS OF THE
PENSION BENEFIT GUARANTY CORPORATION

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will conduct a hearing to review the administration and operations of the Pension Benefit Guaranty Corporation (PBGC). The hearing has been scheduled for Tuesday, April 20, 1993, beginning at 9:30 a.m., in the main Committee hearing room, 1100 Longworth House Office Building.

The Subcommittee will receive testimony from representatives of the Department of Labor, the Department of the Treasury, PBGC, the Congressional Budget Office (CBO), and the U.S. General Accounting Office (GAO).

In announcing this hearing, Chairman Pickle stated: "In 1974, the Congress established PBGC to insure the pension benefits of American workers in defined-benefit pension plans. Presently, PBGC protects the retirement benefits of over 40 million workers. People who work hard for a lifetime are entitled to have protection of their retirement benefits and should not have to fear that someday their pension will be gone or less than promised. The Congress intended that PBGC be a self-financing entity with income generated from premiums paid by sponsors of defined-benefit pension plans, investment income, assets from terminated pension plans, and recoveries from the companies responsible for the terminated plans.

"PBGC's financial reports indicate that the agency has sufficient cash flow to continue its operations at this time. However, its ability to operate as a self-financing insurance agency may cease at the end of this decade or the next. The reason is that companies continue to make pension promises which they have not funded. At the end of 1992, employers' unfunded pension promises reached $51 billion, up by more than $10 billion in one year, and PBGC's accumulated deficit in its single-employer fund reached $2.7 billion, up by $200 million in one year. As PBGC and the pension system become more threatened, the options become more clear: take steps now to prevent additional decay and revive PBGC and our present pension system, or sit back and allow the decay to continue until the insurance system is no longer viable and a taxpayer-financed bailout is required.

"I believe it is time for the Congress and the Administration to take steps to prevent this problem from getting any worse. We must work together to ensure the solvency of PBGC. We must make certain that pension plan sponsors fund the benefits they promise; we must insist that, at a minimum, underfunded pension plans not allow their financial conditions to worsen; we must work toward insurance premium charges which encourage better funding by adequately reflecting the risk which underfunded plans pose to PBGC; and, we must ensure that workers know the solvency of their plans and whether their benefits are insured. Otherwise, we may be facing a savings-and-loan-type bailout in five to ten years.

"I look forward to hearing from the Departments of the Treasury and Labor about the Administration's views on the need for pension reform, and any specific proposals or plans they may have."

(MORE)

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written comments for the printed record of the hearing should submit six (6) copies by the close of business, Thursday, May 20, 1993, to Janice Mays, Chief Counsel and Staff Director, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

######

Chairman PICKLE. The subcommittee will please come to order. We ask our guests to please take a seat.

I have an opening statement, and then I am going to recognize Mr. Herger for an opening statement.

Again, the Oversight Subcommittee meets to discuss the status of the defined benefit pension system and the Pension Benefit Guaranty Corporation. The purpose of this hearing is to provide this subcommittee and the administration with an opportunity to set the course and the direction for action. I want to understand the administration's views on PBGC's operations and the entire defined benefit pension system, and the date on which this subcommittee might expect to receive the administration's legislative recommendations.

On March 9, during testimony before the full committee, I asked OMB Director Leon Panetta about the timing involved with legislative action to address the pension plan underfunding and the PBGC's solvency. Director Panetta indicated that a task force was meeting on these issues, and he expected the task force would have completed its action in time for reconciliation. Well, reconciliation has been moving forward, and there is no sign of where the administration stands on the problem—$50 billion in pension plan underfunding and a deficit at PBGC of $2.5 billion, both of which are growing alarmingly.

The administration is well aware that reconciliation may be the most appropriate legislative vehicle for action this year and, as such, has provided this committee with $300 billion in proposals for inclusion in that bill. Regrettably, PBGC and pension reform were not part of the administration's legislative package, and I regret that.

I have heard that the administration may need until September—4 more months—to consider this matter. My personal opinion is that September is not soon enough. There is no reason why the Congress should not act immediately to stop underfunded pension plans from making more unfunded promises. If it seems that I believe in rushing this matter, it is for good reason because, by mid-September, some companies sponsoring the worst-funded pension plans, specifically those in the automobile industry, will probably have completed negotiation of a 3-year contract with their workers. If history repeats itself, there will be billions of dollars of new pension promises made and perhaps not one penny put into the pension pot by some of these companies. Waiting 4 months does have consequences and could be extremely costly for the American taxpayers guaranteeing these new benefits.

I believe that pension reforms should be included in this reconciliation bill. I take this position not to be uncooperative, but because I believe it is the right thing to do for this country.

I do not know what the administration expects to propose or when the administration's overall plans could be ready for submission to the Congress. I hope that we learn more about this today. With that in mind, I look forward to our first hearing involving the new administration.

Now the Chair recognizes Congressman Herger for any opening statement. Mr. Herger.

Mr. HERGER. Mr. Chairman, I am pleased to join you in opening our hearing on the pension issue facing the Pension Benefit Guaranty Corporation.

Today's hearing is a followup to our pension hearing of February 4. Two months ago, we heard testimony from the outgoing head of the PBGC. He painted a sobering picture of the financial outlook for U.S. pensions and the potential liability of the PBGC. Today we will hear from the new administration team.

There are two points we are anxious to examine: Number one, what is the administration's evaluation of the financial condition of the U.S. pension system and the potential liability of the PBGC? Do you share the sobering projections of the Bush team, or do you disagree? Second, how does the administration propose to address the weaknesses in the U.S. pension system and the financial liability of the PBGC?

In particular, Mr. Chairman, you have introduced legislation, H.R. 298, which begins to address these serious pension issues. We want to learn the position of the administration on this legislation.

Mr. Chairman, I look forward to working with the administration and you in addressing the problem areas in the U.S. pension system.

Thank you.

Chairman PICKLE. Thank you, Mr. Herger.

Do any other members have an opening statement?

[No response.]

Chairman PICKLE. Mr. Slate, I am going to recognize you first. Let me say we have a panel consisting of Mr. Martin Slate, the Executive Director of the Pension Benefit Guaranty Corporation. Mr. Slate, will you identify the person who accompanies you?

Mr. SLATE. Yes. Carol Flowe, the General Counsel of the PBGC, is to my right.

Chairman PICKLE. We are glad to have you, Ms. Flowe.

Then we have a representative of the Department of Labor, Mr. Alan Lebowitz, Deputy Assistant Secretary of Labor for Pension and Welfare Benefits. Mr. Lebowitz, will you identify your person?

Mr. LEBOWITZ. Good morning, Mr. Chairman. To my left is Robert Doyle, the Director of Regulations and Interpretations for the Pension Welfare Benefits Administration.

Chairman PICKLE. Thank you, Mr. Lebowitz.

And now we have Mr. Randolf Hardock, Office of Tax Policy, representing the Department of Treasury.

Mr. HARDOCK. Mr. Pickle, I am accompanied by the Government Actuary for the Treasury Office of Tax Policy, Harlan Weller.

Chairman PICKLE. We are glad to have all of you individuals with us this morning.

Our first witness will be Mr. Martin Slate, followed by Mr. Lebowitz and Mr. Hardock. So, Mr. Slate, if you will present your statement?

STATEMENT OF MARTIN SLATE, EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION, ACCOMPANIED BY CAROL FLOWE, GENERAL COUNSEL

Mr. SLATE. Thank you, Mr. Chairman and members of the subcommittee.

Thank you for inviting me to appear before the subcommittee. In my previous position at the Internal Revenue Service working in the employee benefits area, I was very much aware of the major role this subcommittee plays in the protection of worker benefits. I am pleased you have asked me to discuss the Pension Benefit Guaranty Corporation and issues affecting its future.

I am honored to have been appointed Executive Director of the PBGC. During my 10 years at the IRS, I had many occasions to work with the PBGC. I have always been impressed with the PBGC's hard-working employees and their commitment to protecting the interests of plan participants.

Secretary Reich, the other members of the PBGC's Board of Directors, and I share the subcommittee's concern for the important purpose for which the PBGC was created: to provide retirement income security for the millions of working people participating in private defined benefit pension plans. We are committed to the most effective possible retirement system for our Nation's work force. Workers who have a lifetime investment in their pensions must have their expectations honored. Secretary Reich and I look forward to working closely with you and the subcommittee as the PBGC moves forward to see that benefit promises to our Nation's workers are kept.

In my testimony, I will address the items raised in your letter of April 1. I will first discuss the work of the administration's task force that is studying the PBGC. Also, I will provide information on the financial condition of the PBGC, PBGC's exposure, and plan underfunding. I will then discuss plan funding waivers, the furnishing of information to plan participants, and the data needs of the PBGC. Finally, as you asked, I will set forth my overall goals for the agency.

In March, Secretary Reich established an interagency task force to study the PBGC. The Secretary moved at this early point because of the importance he and the administration place on pension security. We are committed to keeping the pension system strong for those who count on their pensions as they look ahead to retirement. I will give you a status report on the progress of the task force, understanding that its work is ongoing and that we have not yet reached any conclusions or made any recommendations to Secretary Reich and the other members of the PBGC's board of directors.

The task force represents an intensive effort to examine the concerns that have been raised about the PBGC and worker protections. In this way, we can come to a full understanding of the situation. The task force includes representatives of the PBGC, the Departments of Labor, Commerce, and Treasury, which make up the PBGC's board; and representatives of the Office of Management and Budget, and the President's National Economic Council. Thus, the task force includes people with varying pension responsibilities and perspectives, as well as those with broader economic and social charges.

The group held its first meeting on March 10 and has been meeting on an intensive and regular basis to gather and explore information on a broad range of issues. We have met the task force's

first goal of conducting a series of analytic briefings before mid-April.

The task force is meeting with representatives of interested congressional committees. In addition, the task force will be meeting with a broad range of public groups, including worker and business representatives and other pension experts to understand their perspectives on the issues.

Chairman PICKLE. Mr. Slate, let me interrupt you at this point.

Mr. SLATE. Yes, sir.

Chairman PICKLE. When you say that your task force is meeting with representatives of interested congressional committees, this committee has been invited to one of your meetings.

Mr. SLATE. Yes. They were here last week, and they contributed mightily to our work, sir.

Chairman PICKLE. Well, my concern is that we be kept posted. We have attended one meeting; you have had four or five. We expect this committee to be kept advised of the progress that your task force is making.

I assume that no other congressional committee is sitting in your task force if this committee isn't, except when we are invited. If there are other congressional groups, I would want this committee to always be included. If they are not, then I want you to keep us informed as we go along. Is that understood?

Mr. SLATE. Oh, yes, sir. And when I assumed the PBGC executive directorship at the end of March, the first thing that I did was insist that the task force reach out and invite representatives of the committee, and we will keep you and all appropriate people informed as we move ahead.

Mr. SANTORUM. Mr. Chairman, if you will yield? I have been informed by our minority staff that we have not been involved in any of these discussions on the minority side, and I would appreciate, if any further discussions are held, that the minority be included in those discussions.

Mr. SLATE. Absolutely.

Mr. SANTORUM. Thank you.

Chairman PICKLE. I would endorse that, too.

Go ahead, Mr. Slate.

Mr. SLATE. We expect that the work of the task force will culminate in recommendations for Secretary Reich and the other members of the PBGC's board of directors. To that end, the task force is studying a variety of issues pertaining to protection of worker benefits. These include an examination of the minimum funding rules, trends in pension underfunding, PBGC's financial condition, the impact of bankruptcy, and the PBGC's premium and guarantee structures. We are drawing heavily from experts in each of these areas, reviewing the history, policies, rules, and concerns in these areas, and seeking to relate these inquiries to broader retirement and economic concerns.

At this early point in the process, there is a consensus emerging in the task force that there are long-term problems with the PBGC's single-employer insurance program that can, with careful and thoughtful study, be addressed. Although the task force has reached no formal conclusions on the exact extent of PBGC's problems and precisely how they should be addressed, my own prelimi-

nary assessment of the current situation can be summarized in three basic points.

First, the pension benefits protected by the PBGC are safe. PBGC has more than sufficient revenues and assets on hand to make benefit payments as they come due for some time in the future. Even the most pessimistic forecast shows that the agency will have enough cash flow and assets to meet its obligations for many years.

Second, steps will need to be taken to assure that the PBGC is able to protect workers' benefits over the long term. The PBGC has an accumulated deficit of $2.7 billion that almost surely will grow over time given trends in the economy and how the law is now structured.

There are many underfunded plans sponsored by companies that are in difficult circumstances. If recent trends continue, those difficulties could translate into claims on the PBGC. In addition, there is a mismatch between the timing of funding and benefit protections. This can result in benefits being unprotected even though a sponsor is meeting all of its funding obligations.

In other areas as well, the law does not provide the PBGC with all the tools necessary to control losses to the insurance program and, more importantly, to plan participants. For example, benefit claims often take a back seat in the bankruptcy forum.

Finally, most private defined benefit pension plans are sound. In fact, most plans are overfunded. There are, however, significant shortfalls in a discrete number of plans. How to address these shortfalls in the context of overall pension policy is the challenge that the task force must face.

I will now turn to underfunding.

Based on the most recent data available from SEC filings, pension underfunding in all single-employer plans was about $40 billion at the end of 1991. In inflation-adjusted terms, pension underfunding held relatively steady from 1986 through 1989, at approximately $30 billion, and increased about $10 billion over the 2-year period 1990 through 1991. About half of the increase in underfunding is due to falling interest rates. Much of the balance is due to benefit increases in a few industries. Indeed, underfunding appears to have become more concentrated in a relatively few firms and plans, primarily in the automobile, steel, tire, and airline industries. At least $12 billion of the underfunding is associated with firms that represent, in accounting parlance, "reasonably possible" claims against the agency. But it should be kept in mind that it is extremely unlikely that all these companies will fail; it is also unlikely that any significant number of the failures that do occur will occur within the next several years.

The task force is reviewing the causes of plan underfunding and how it affects PBGC's ability to protect participants. We certainly will be looking at the proposals in the Pension Funding Improvement Act of 1993.

I would now like to turn to the matters you have raised with respect to funding waivers, information to participants on plan solvency, and the PBGC's own information needs. In the interest of time, I will abbreviate the remarks in my written testimony.

Thanks to the 1986 and 1987 legislation, prompted by your subcommittee and others, the funding waiver process has been tightened. A plan sponsor can ask the IRS to waive its required annual minimum funding contribution to a plan. If a plan has an accumulated funding deficiency of $1 million of more, the IRS may require that, as a condition for granting a waiver, the plan sponsor provide security to the plan. The law requires that the IRS consult with the PBGC before granting a waiver for these plans.

During my time at the IRS, I made this area a high priority and worked closely with the PBGC to assure its success. As a result of the legislation, the overall number of waiver requests went down from an average of 800 per year in the mid-1980s to its current average of just under 100 a year. Since 1988, the IRS has received only 36 requests for waivers or modifications subject to the security provisions of the legislative reforms.

On information to plan participants, it is, of course, in the interests of participants and PBGC to focus attention on the importance of plan funding to benefit security while a plan is ongoing and after it terminates. Although ERISA already has extensive participant information requirements, we intend to explore with our colleagues at the PWBA how best to educate plan participants in ongoing plans about how plan funding levels and limits on PBGC's guarantee may affect benefit security. In my written testimony, I discuss our efforts to educate participants in terminated plans about their guaranteed benefits.

As for the PBGC's information needs, the agency could do better if we had better information on large plans and their sponsors.

With respect to your question concerning the information provided on form 5500, it has been PBGC's experience that more detailed actuarial information on large plans is needed. Most of this information is in a plan's annual valuation report or in supporting work papers. We will be working with the other ERISA agencies, OMB, and the interested public on how best to obtain this data.

In addition, the PBGC needs better corporate information to give us early warning of potential problems. Under current law, we do not receive advance notice of corporate events that makes plan termination more likely or that increases the amount of loss to participants or the PBGC when plans terminate, such as major restructurings.

I am pleased that your bill, Mr. Chairman, would allow us to obtain this information more timely and to obtain better plan and company information.

Finally, I would like to discuss my overall goals for the PBGC.

First and foremost, we must remember that the PBGC exists to assure workers' retirement income security. To do this, we must keep the program financially sound, while always remembering this broader social objective.

Second, we must provide the best possible service to participants who look to us for their pension benefits, and we must deliver that service efficiently.

Toward that end, I want the PBGC to be known as a well-managed agency. We should work to see that our management functions meet the highest professional standards and that our people achieve their maximum potential. We are assembling a highly sea-

soned management team to direct the agency. We have already hired two noted professionals, William Posner and Ellen Hennessy, as our chief operating officer and chief negotiator. We plan to hire a chief financial officer to direct the agency's finances, hopefully as early as this week. Also this week we will be establishing and filling a new position, chief management officer. The chief management officer will oversee the agency's personnel, planning, and budget functions.

You also asked about the agency's progress in improving PBGC's information systems for estimating liability for future benefits and processing premiums. These are among the items cited by the General Accounting Office as needing attention. My first order of business was to review these areas. While I have found that there has been progress, considerable work remains to be done. In particular, the agency has yet to develop an automated, redesigned premium system.

We are totally committed to completing the work to improve PBGC's financial systems and controls. We plan to work out a detailed plan with officials from GAO and OMB to address these matters. Our ability to put our house in order will go a long way toward assuring the public of the PBGC's ability to perform its role.

I would like to make one final point, Mr. Chairman. The work of the PBGC has a broad-reaching effect—on pension plan participants, on their representatives, and on employers, large and small, from all parts of the country. It is essential as we move forward to assure an effective PBGC that we reach out to include the entire benefits community in the process.

I look forward to working closely with this subcommittee in addressing the pension interests of America's workers and retirees.

[The prepared statement follows:]

TESTIMONY OF MARTIN SLATE
Executive Director
of the
Pension Benefit Guaranty Corporation

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to appear today before the Subcommittee. In my previous position at the Internal Revenue Service (IRS), in the employee benefits area, I was very much aware of the major role this Subcommittee plays in the protection of workers' benefits. I am pleased you have asked me to discuss the Pension Benefit Guaranty Corporation (PBGC) and issues affecting its future.

I am honored to have been appointed Executive Director of the PBGC. During my ten years at the IRS I had many occasions to work with the PBGC. I have always been impressed with the PBGC's hard-working employees and their commitment to protecting the interests of plan participants.

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<u>Administration's Task Force on PBGC</u>

In March, Secretary Reich established an inter-agency task force to study the PBGC. The Secretary moved at this early point because of the importance he and the Administration place on pension security. We are committed to keeping the pension system strong for those who count on their pensions as they look ahead to retirement. I will give you a status report on the progress of the task force, understanding that its work is ongoing and that we have not yet reached any conclusions or made any recommendations to Secretary Reich and the other members of PBGC's Board of Directors.

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The group held its first meeting on March 10 and has been meeting on an intensive and regular basis to gather and explore information on a broad range of issues. We have met the task force's first goal of conducting a series of analytic briefings before mid-April.

The task force is meeting with representatives of interested congressional committees. In addition, the task force will be meeting with a broad range of public

groups, including worker and business representatives and other pension experts to understand their perspectives on the issues.

We expect that the work of the task force will culminate in recommendations for Secretary Reich and the other members of PBGC's Board of Directors. To that end, the task force is studying a variety of issues pertaining to protection of workers' pension benefits. These include an examination of the minimum funding rules, trends in pension underfunding, PBGC's financial condition, the impact of bankruptcy, and the PBGC's premium and guarantee structures. We are drawing heavily from experts in each of these areas -- reviewing the history, policies, rules and concerns in these areas, and seeking to relate these inquiries to broader retirement and economic concerns.

At this early point in the process, there is a consensus emerging in the task force that there are long-term problems with PBGC's single-employer insurance program that can -- with careful and thoughtful study -- be addressed. Although the task force has reached no formal conclusions on the exact extent of PBGC's problems and precisely how they should be addressed, my own preliminary assessment of the current situation can be summarized in three basic points.

First, the pension benefits protected by PBGC are safe. PBGC has more than sufficient revenues and assets on hand to make benefit payments as they come due for some time in the future. Even the most pessimistic forecast shows that the agency will have enough cash flow and assets to meet its obligations for many years.

Second, steps will be needed to assure that the PBGC is able to protect workers' benefits over the long-term. The PBGC has an accumulated deficit of $2.7 billion that almost surely will grow over time given trends in the economy and how the law is now structured.

There are many underfunded plans sponsored by companies that are in difficult circumstances. If recent trends continue, those difficulties could translate into claims on the PBGC. In addition, there is a mismatch between the timing of funding and benefit protections. This can result in benefits being unprotected even though a sponsor is meeting all of its funding obligations.

In other areas as well, the law does not provide PBGC with all the tools necessary to control program losses to the insurance program and, more importantly, to plan participants. For example, benefit claims often take a back seat in the bankruptcy forum.

Finally, most private, defined-benefit pension plans are sound. In fact, most plans are overfunded. There are, however, significant shortfalls in a discrete number of plans. How to address these shortfalls in the context of overall pension policy is the challenge that the task force must face.

Underfunding

Based on the most recent data available from SEC filings, pension underfunding in all single-employer plans was about $40 billion at the end of 1991. In inflation-adjusted terms, pension underfunding held relatively steady from 1986 through 1989 at approximately $30 billion, and increased about $10 billion over the period 1990 through 1991. About half of the increase in underfunding is due to falling interest rates. Much of the balance is due to benefit increases in a few industries. Indeed, underfunding appears to have become more concentrated in a relatively few firms and plans, primarily in the automobile, steel, tire and airline industries. At least $12 billion of the underfunding is associated with firms that represent, in accounting parlance, "reasonably possible" claims against the agency. But it should be kept in mind that it is extremely unlikely that all these companies will fail; it is also unlikely that any significant number of the failures that do occur will occur within the next several years.

As noted above, the task force is reviewing the causes of plan underfunding and how it affects PBGC's ability to protect participants. We certainly will be looking at the proposals in the Pension Funding Improvement Act of 1993, H.R. 298.

Current Status of Funding Waivers

Thanks to legislation enacted in 1986 and 1987, prompted by your Subcommittee and others, the funding waiver process has been tightened. A plan sponsor experiencing "temporary substantial business hardship" can ask the IRS to waive all or part of its required annual minimum funding contribution for a plan covered by PBGC insurance. If a plan has an accumulated funding deficiency of $1 million or more, the IRS may require that, as a condition for granting or modifying a waiver, the plan sponsor provide security to the plan. The law requires that the IRS consult with the PBGC before granting or modifying a waiver for these plans.

During my time at the IRS, I made this area a high priority and worked closely with the PBGC to assure its success. As a result of the legislation, the overall number of waiver requests went down from an average of 800 per year in the mid-1980's to its current average of just under 100 per year. From January, 1988 through February, 1993, IRS received only 36 requests for waivers or modifications subject to the security provisions of the legislative reforms. Of the total $611 million involved, requests were denied with respect to $316 million. Of the $295 million in waivers granted, 81 percent was secured. The new legislation made waivers less attractive because of the security requirement, the shorter amortization period for paying off waivers, the higher interest rates that apply to contributions deferred through waivers, and the lower limit on the number of permitted waivers.

Plan Solvency and Guaranty Information for Participants

Testimony from my colleagues from the PWBA will address your questions concerning the provision of information to participants in ongoing plans on plan solvency and PBGC guarantees. It is in the interests of both participants and the PBGC to focus attention on the importance of plan funding to benefit security while a plan is ongoing. Although ERISA already has extensive participant information requirements, we intend to explore with the PWBA how best to educate plan participants in ongoing plans about how plan funding levels and limits on PBGC's guarantee may affect benefit security.

Of course, good communication with participants is also critical after a plan terminates. In response to requests during the last 12 months from plan participants in both ongoing and terminated plans, PBGC has distributed more than 80,000 booklets describing PBGC's guarantee. In addition, we have established a staff group to evaluate and improve our communications with participants. We now are exploring how to survey participants in terminated plans to find what improvements they would like to see in all of our communications and other services.

Information Needs of PBGC

I turn now to the information PBGC needs to enable us to do a better job. The agency would be more effective if we had better information on large plans and their sponsors.

With respect to your question concerning the information provided on Form 5500, it has been PBGC's experience that more detailed actuarial information on large plans is needed. Virtually all of this information is in a plan's annual valuation report or in supporting workpapers. We will be working with the other ERISA agencies, OMB and the interested public on how best to obtain this data.

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In addition, the PBGC needs better corporate information to give us early warning of potential problems. Under current law, we do not get advance notice of corporate events that make plan termination more likely or that increase the amount of loss to participants or the PBGC when plans terminate. Types of events that we need to know about are spinoffs and major restructurings that change the controlled group; plan amendments significantly increasing benefits; transfer of liabilities from one controlled group to another; and granting of secured interests to other creditors.

I am pleased, Mr. Chairman, to find that your bill, H.R. 298, would allow us to obtain more timely, and better, plan and company information.

Goals For PBGC

Finally, I would like to discuss my overall goals for the PBGC:

First and foremost, we must remember that the PBGC exists to assure workers' retirement income security. To do this, we must keep the program financially sound, while always remembering this broader social objective.

Second, we must provide the best possible service to participants who look to us for their pension benefits -- and we must deliver that service efficiently.

Toward that end, I want the PBGC to be known as a well-managed agency. We should work to see that our management functions meet the highest professional standards and that our people achieve their maximum potential. We are assembling a highly-seasoned management team to direct the agency.

You also asked about the agency's progress in improving PBGC's information systems for estimating liability for future benefits and processing premiums. These are among the items cited by the General Accounting Office (GAO) as needing attention. My first order of business was to review these areas. While I have found that there has been progress, considerable work remains to be done.

With respect to the present value of future benefits, last year PBGC's systems for estimating this liability were validated and documented. The consulting firm of Coopers & Lybrand certified that these systems conform to generally accepted actuarial methodologies and that they are auditable. In addition, we have completed and corrected most of the data errors in the system. Controlling the quality of data will continue to be a priority.

The agency has yet to develop an automated, redesigned premium system. To bridge the gap, the agency has created an interim premium accounting and collection system. We have billed $32 million in premiums, interest and penalties for 1988-1992 and collected $8 million thus far. We have collected an additional $29 million from non-filers who owed premiums and we are extending the reach to non-filing plans of smaller size. We are establishing a new unit for collecting premiums from difficult accounts. In fiscal year 1992, we collected approximately $1 million through collection agencies and civil litigation.

We are totally committed to completing the work to improve PBGC's financial systems and controls. Within the coming weeks, we plan to hire a Chief Financial Officer and to work out a detailed plan with officials from GAO and OMB to address these matters. Our ability to put our house in order will go a long way toward assuring the public of the PBGC's ability to perform its role.

Concluding Remarks

I would like to make one final point, Mr. Chairman. The work of the PBGC has a broad-reaching effect -- on private, defined-benefit pension plan participants, on their representatives, and on employers (large and small), from all parts of the country. It is essential as we move forward to assure an effective PBGC, that we reach out and include the entire benefits community in the process.

I look forward to working closely with this Subcommittee in addressing the pension interests of America's workers and retirees.

At this time, I would be happy to answer any questions you may have.

Chairman PICKLE. Thank you, Mr. Slate. You mentioned that your agency has hired or is in the process of hiring some additional professionals to help complete this study and the work. We ask that you give this committee the names of those persons who have been hired or who have been put in charge of making some of these decisions. We ask you to furnish those names.

Mr. SLATE. Absolutely delighted to, sir.

[The information follows:]

RESPONSE TO CHAIRMAN PICKLE'S REQUEST THAT MR. SLATE PROVIDE THE NAMES OF NEWLY HIRED MEMBERS OF PBGC'S MANAGEMENT TEAM

Ellen Hennessy and William Posner, two highly accomplished pension professionals, will be serving as Deputy Executive Directors in the program area. We have hired as Deputy Executive Director and Chief Financial Officer Anthony Calhoun, who is now the Controller of the District of Columbia. We have also established a Chief Management Officer to oversee the personnel, planning, and other managerial aspects of the agency. John Seal, a veteran of the Office of Management and Budget, who has served as Managing Director in two Federal agencies, will assume the Chief Management Officer role. Judy Schub, who has worked on Federal legislative relations for the American Association of Retired Persons and other national organizations, will serve as Assistant Executive Director for Legislative Affairs.

Chairman PICKLE. Second, I have clear indications from your testimony that your task force will make specific recommendations to the Secretary of Treasury as to their recommended course of action. Is that correct?

Mr. SLATE. Yes. The task force will make recommendations, yes, sir.

Chairman PICKLE. Or legislative recommendations?

Mr. SLATE. The task force will make recommendations. It is my own personal assessment that legislative steps need to be taken to address the situation.

Chairman PICKLE. It would do what? Would you repeat that?

Mr. SLATE. Sir, excuse me. The task force will make recommendations. I think I was saying that it is my own personal assessment that legislative steps will need to be taken to address the long-range concerns.

Chairman PICKLE. The meeting that a representative of our committee attended with your department and with the Labor Department indicated that your task force would not be charged with making specific recommendations. This committee simply wants to know: Will they make recommendations or will they not?

Mr. SLATE. The task force will make recommendations to Mr. Reich, but I think, just to clear it up, the task force is not charged with making specific legislative recommendations. They may, they may not, but they will make recommendations.

Chairman PICKLE. Then you are saying to me that they will make general findings of facts and recommendations, but nothing specific in the form of legislation?

Mr. SLATE. It is hard to predict; it is still premature. But I think that could happen, sir.

Chairman PICKLE. Well, we will be following that closely because we ask ourselves what is the purpose of the task force if it is not to make recommendations. And if you are going to make recommendations, we hope that they will be specific enough that some action can take place from that.

Now, I am going to suggest to the subcommittee that we go ahead with the witnesses, the other two witnesses, and then ask questions. Is that agreeable?

All right. Then the next witness will be Mr. Alan Lebowitz, Deputy Assistant Secretary of Labor. Mr. Lebowitz?

STATEMENT OF ALAN D. LEBOWITZ, DEPUTY ASSISTANT SECRETARY OF LABOR FOR PENSION AND WELFARE BENEFITS, U.S. DEPARTMENT OF LABOR

Mr. LEBOWITZ. Good morning, Mr. Chairman and members of the subcommittee. I am Alan D. Lebowitz, Deputy Assistant Secretary of Labor for Pension and Welfare Benefits. Accompanying me today is Robert Doyle, Director of Regulations and Interpretations in the Pension and Welfare Benefit Administration. I would like to summarize my testimony and submit my written statement for the record.

Chairman PICKLE. Without objection, all the testimony of the witnesses will be included in the record.

Mr. LEBOWITZ. I am pleased to be here today to testify on information and disclosure requirements under the Employee Retirement Income Security Act, ERISA, that are intended to inform plan participants of their plan's financial status. Before addressing those topics, however, I want to commend Chairman Pickle for his commitment to protecting the retirement security of participants and beneficiaries under private pension plans. I also want to emphasize that we at the Department of Labor share this commitment.

Chairman Pickle's letter of invitation to Secretary Reich asked him to describe his overall goals for the PBGC and pension income security and what should be done to address underfunding in defined benefit pension plans.

To assess the financial condition and long-term health of the PBGC, Secretary Reich established an interagency task force in March to review issues related to the PBGC as an orderly way of bringing early recommendations to him and the other members of the board of directors of PBGC. Upon completion of its work, the task force will make recommendations to Secretary Reich and the other board members for their consideration.

The letter of invitation asked us to discuss the adequacy of current law requirements for disclosure by a plan sponsor of the plan's financial status to plan participants, specifically with regard to whether a plan is solvent, whether the benefits are insured by PBGC, and whether a request for a funding waiver has been requested or granted.

ERISA contains a number of disclosure requirements that are intended to provide plan participants and beneficiaries with information relating to a plan's funding status, requests for funding waivers, and whether benefits are guaranteed by the PBGC.

The first disclosure document that ERISA requires plan administrators to furnish to participants and beneficiaries is a summary plan description, SPD. ERISA requires the SPD to be written in a manner calculated to be understood by the average plan participant and to be sufficiently accurate and comprehensive to reasonably apprise participants and beneficiaries of their rights and obligations under the plan.

In addition, our regulations require that the SPD disclose whether benefits under the plan are insured under title IV of ERISA. These rules also require the SPD to include a summary of the pension benefit guaranty provisions of title IV, and a statement indicating that further information on the provisions of title IV can be obtained from the plan administrator, or the PBGC. The address of the PBGC must also be provided.

As you requested, copies of disclosure statements have been provided to the staff. More detailed discussion of SPDs is included in my written submission.

The letter of invitation asked whether current law requires disclosure by plan sponsors of the plan's financial status. ERISA section 104(b)(3) requires a plan administrator to furnish a summary annual report to each participant of an ERISA-covered pension plan and to each beneficiary receiving benefits under the plan. The summary annual report is a narrative summary of important financial information taken from the plan's annual report on form 5500. The summary annual report must include a statement that sufficient money was contributed to the plan to meet ERISA's minimum funding standards or, if insufficient funds were contributed, the amount of any deficit, and if the current value of the assets of the plan is less than 70 percent of the current liability under the plan, the percentage which such value is of such liability.

You asked that we discuss whether current law requires participants to be informed of whether a funding waiver has been requested or granted. ERISA requires any applicant for a waiver to provide evidence satisfactory to the Secretary of the Treasury that the applicant has provided participants with notice that it has applied for a funding waiver. The notice must describe the extent to which the plan is funded with respect to guaranteed benefits and for benefit liabilities.

Now I would like to turn to your question regarding the adequacy of information on form 5500, whether it is available to policymakers and the public on a full and timely basis, and whether plans are complying with the requirement that the form 5500 be made available on request. More detailed information on these points is included in my written submission.

As you are aware, a defined benefit plan is required to file an annual report with the Department of Labor, the PBGC, and the Internal Revenue Service. Overall, PWBA has found that the information required to be reported on form 5500 has been adequate to allow it to meet its responsibility to administer and enforce ERISA. The interagency task force is examining whether schedule B, which provides information on plan funding, needs to be changed to contain more detailed information.

I am pleased to be able to report that we have made great strides in improving our systems so that we are able to rapidly access the form 5500 series and in assuring, as far as possible, that the form 5500 filings are complete and accurate. We coordinate closely with the IRS with respect to receipt of the annual reports and their entry into the ERISA database system. As a result of our vigorous filing enforcement policy, I can say that our ERISA annual report database has never been more complete or more accurate than it is today.

Information contained on the form 5500 is available to policymakers and the public on a full and timely basis through the Public Disclosure Room, which can provide computer-generated copies of the specific forms on a walk-in basis or pursuant to written requests.

We have no empirical data on whether plans are complying with the requirement that form 5500 be made available to participants on request. However, PWBA's Division of Technical Assistance and Inquiries, which responds to written and telephone inquiries from individuals who have complaints or problems regarding their employee benefit plans, has found that participants have not identified this as a problem.

Administrators are required, upon receipt of a written request of a participant or beneficiary, to furnish a copy of the latest SPD, SAR, or form 5500. The administrator may make a reasonable charge to cover the cost of furnishing copies of these documents. If a plan administrator fails to comply with a participant or beneficiary's request to receive such information, within 30 days after the request, a court can assess a penalty against the administration of up to $100 a day payable to the participant or beneficiary.

Documents required to be sent to participants and beneficiaries on request must also be made available for examination. Our regulations require that the SPD disclose the right for participants and beneficiaries to view or request copies of additional information.

PWBA investigators routinely check for SPD, SAR, and annual report compliance, and when noncompliance is found, appropriate enforcement action is taken that is merited under the circumstances. This includes assessment of civil penalties of up to $1,000 a day for failure to file a timely and complete annual report.

I hope this information is helpful to you as the committee considers reforms affecting the PBGC. I would be pleased to answer any questions that you may have.

Thank you.

[The prepared statement and attachment follow:]

Statement of
Alan D. Lebowitz
Deputy Assistant Secretary of Labor for
Pension and Welfare Benefits
before the
U.S. House of Representatives
Committee on Ways and Means
Subcommittee on Oversight
April 20, 1993

I. Introduction

Good morning Mr. Chairman and Members of the Subcommittee. I am Alan D. Lebowitz, Deputy Assistant Secretary of Labor for Pension and Welfare Benefits. Accompanying me today is Robert Doyle, Director of Regulations and Interpretations in the Pension and Welfare Benefit Administration. I am pleased to be here today to testify on information and disclosure requirements under the Employee Retirement Income Security Act (ERISA) that are intended to inform plan participants of their plan's financial status.

Before addressing those topics, however, I want to commend Chairman Pickle for his commitment to protecting the retirement security of participants and beneficiaries under private pension plans. I also want to emphasize that we at the Department of Labor share this commitment.

Chairman Pickle's letter of invitation to Secretary Reich asked him to describe his overall goals for the PBGC and pension income security and what should be done to address underfunding in defined benefit pension plans.

Secretary Reich is concerned about the threat to PBGC's long-term financial viability. To assess the financial condition and long-term health of the PBGC, Secretary Reich established an inter-agency task force in March to review issues related to the PBGC as an orderly way to bring early recommendations to him and the other members of the Board of Directors of the PBGC. The task force is examining all available information to determine the impact of underfunding in defined benefit plans and related issues. Upon completion of its work, the task force will make recommendations to Secretary Reich and other Board members for their consideration. I will not discuss underfunding, as Mr. Slate's testimony discusses this in more detail.

II. ERISA Disclosure Requirements

The letter of invitation asked us to discuss the adequacy of current law requirements for disclosure by a plan sponsor of the plan's financial status to plan participants, specifically with regard to whether a plan is solvent, whether the benefits are insured by PBGC, and whether a request for a funding waiver has been requested or granted.

ERISA contains a number of disclosure requirements that are intended to provide plan participants and beneficiaries with information relating to a plan's funding status, requests for funding waivers, and whether benefits are guaranteed by the PBGC.

A. Summary Plan Description

The first disclosure document that ERISA requires plan administrators to furnish to participants and beneficiaries is a summary plan description (SPD). Section 102(a)(1) of ERISA requires the SPD to be written in a manner calculated to be understood by the average plan participant and to be sufficiently accurate and comprehensive to reasonably apprise participants and beneficiaries of their rights and obligations under the plan.

In addition, our regulations require that the SPD disclose whether benefits under the plan are insured under Title IV of ERISA. These rules also require the SPD to include a summary of the pension benefit guaranty provisions of Title IV, and a statement indicating that further information on the provisions of Title IV can be obtained from the plan administrator or the PBGC (the address of the PBGC must also be provided). The regulations provide a model notice that can be used to meet this requirement. This notice clearly states in part that the "PBGC does not guarantee all types of benefits under covered plans, and the amount of benefit protection is subject to certain limitations."

You also asked whether participants are receiving information required to be disclosed under ERISA in a format that is understandable to them. I believe that the SPDs delivered to participants reflect the underlying plans. Where the plans are relatively simple, the SPDs are simple and understandable. However, it is important to note that many pension plans are very complicated, as are the laws and regulations that govern those plans. Furthermore, plan sponsors and administrators are well aware of the liabilities that can result from misstatement of the terms of their plans in an SPD. These factors conspire to make many pension plan SPDs inherently complicated documents. We know that many employers and their advisors try very hard to make these documents as understandable as possible. Moreover, many employers are moving to introduce electronic technology, such as interactive computer programs and video presentations to supplement SPDs so as to assist in providing participants with accurate and understandable plan descriptions and benefit information. I believe that this is a healthy trend.

We at PWBA are concerned that participants understand their plans and their rights under ERISA, as participants are the first line of defense in the enforcement of our pension laws. If they understand the terms of their plans and how their plans operate, participants can exercise informed judgement and oversight of those plans. We are also concerned that many participants do not actually read and utilize the information provided in these documents. Work that the GAO has done has indicated that the participants do not bother to read disclosure materials and, therefore, are uninformed about their plans.

PWBA receives approximately 200,000 SPDs each year. We check all SPD's for identifying information regarding the plan sponsor and the type of plan. This information is then indexed in a computer log and stored for retrieval purposes. The actual SPDs are stored until they are requested by participants and beneficiaries. We get, however, relatively few such requests. In fiscal year 1992, for example, our Public Disclosure Room processed approximately 1,000 requests for copies of SPDs, many of which were not requested by participants or beneficiaries.

We have over the years attempted to audit and assess the understandability of these documents. On the basis of our experience in this area, we believe that SPDs generally serve their intended purpose of conveying accurate plan information in a manner as understandable as possible, given the complexity of the underlying plans. There is always, however, room for improvement.

As you requested, copies of disclosure statements are attached.

B. Summary Annual Report

The letter of invitation asked whether current law requires disclosure by plan sponsors of the plan's financial status.

ERISA section 104(b)(3) requires a plan administrator to furnish a summary annual report to each participant of an ERISA-covered pension plan and to each participant and beneficiary receiving benefits under the plan. The summary annual report is a narrative summary of important financial information taken from the plan's annual report on Form 5500. The summary annual report must include a statement that sufficient money was contributed to the plan to meet ERISA's minimum funding standards or, if insufficient funds were contributed, the amount of any deficit, and if the current value of the assets of the plan is less than 70 percent of the current liability under the plan, the percentage which such value is of such liability.

C. Disclosure of Application for Minimum Funding Waiver

You asked that we discuss whether current law requires participants to be informed of whether a funding waiver has been requested or granted. ERISA section 303(e) requires any applicant for a waiver to provide evidence satisfactory to the Secretary of the Treasury that the applicant has provided participants with notice that it has applied for a funding waiver. The notice must describe the extent to which the plan is funded with respect to guaranteed benefits and for benefit liabilities.

D. Form 5500

Now I would like to turn to your question regarding the adequacy of information on Form 5500, whether it is available to policymakers and the public on a full and timely basis, and whether plans are complying with the requirement that the Form 5500 be made available upon request.

As you are aware, a defined benefit plan is required to file an annual report with the Department of Labor, the PBGC, and the Internal Revenue Service. Overall, PWBA has found that the information required to be reported on Form 5500 has been adequate to allow it to meet its responsibility to administer and enforce ERISA. The inter-agency task force is examining whether Schedule B, which provides information on plan funding, needs to be changed to contain more detailed information.

I am pleased to be able to report that we have made great strides in improving our systems so that we are able to rapidly access the Form 5500 series and in assuring, as far as possible, that the Form 5500 filings are complete and accurate. We coordinate closely with the IRS with respect to receipt of the annual reports and their entry into the ERISA database system. IRS service centers receive the Form 5500 series annual reports from over 800,000 pension and welfare plans that are required to file under Title I of ERISA. The service centers key punch the data and apply a comprehensive series of automated edit tests to identify deficient filings and generate letters to filers requesting that filing deficiencies be corrected. If deficiencies are not corrected within 30 days, a second letter is sent. Experience has shown that nearly 90% of the deficiencies have been corrected as a result of the first letter. If the second letter does not result in correction, the IRS sends the record to PWBA, and we examine the filing for possible rejection and imposition of the applicable penalties under section 502(c)(2) of ERISA. As a result of our vigorous filing enforcement policy, I can say that our ERISA annual report database has never been more complete or more accurate than it is today. In fiscal year 1992, we assessed more than $34.5 million in penalties under section 502(c)(2) against persons who had filed deficient reports. We also initiated a grace period program to encourage nonfilers to come into compliance. Filers took advantage of this program to pay reduced penalties and submitted over 40,000 previously unfiled annual reports during the grace period, which expired on December 31, 1992.

Data obtained from the Form 5500 series reports comprises the ERISA database system which is used for case targeting purposes. The data for all filings are subjected to a comprehensive automated review using specialized targeting criteria to search for potential violations. Annual reports containing information which may be indicative of a violation are flagged by the system and provided to the appropriate field office for a follow-up determination of whether an investigation should be opened.

Prior to its implementation, PWBA was able to review only a small portion of all plans. Now all annual reports are screened for accuracy and completeness and subject to computer targeting. This sophisticated automation system allows us to create the largest possible deterrent effect to help assure that no participant or beneficiary loses his or her pension benefits. In addition, the system allows us to better manage cases and evaluate the results of targeting and investigative techniques.

The automated system is also improving the timeliness of our review. Under the statute, plan sponsors are not required to file the Form 5500 until 7 months after the close of the plan year. A 2-1/2 month extension may also be granted. As a result, an annual report may include financial information relating to transactions that occurred more than 21 months earlier. Through our automated system, however, we and IRS can ensure that further delays will not result by giving us access to the information contained on the Form 5500 within 60 to 90 days after a completed Form 5500 is filed.

Information contained on the Form 5500 is available to policymakers and the public on a full and timely basis through the Public Disclosure Room, which can provide computer-generated copies of the specified forms on a walk-in basis or pursuant to written requests. The bulk of the filings on the Form 5500 series can be retrieved by computer, and a paper copy can be produced for a nominal charge. PWBA also routinely compiles and publishes statistical information derived from the Form 5500. For plans with fewer than 100 participants, which file on Forms 5500 C and R, the entire form can be computer generated. At this point, the Form 5500 and attachments submitted by larger plans are available only on microfiche.

We have no empirical data on whether plans are complying with the requirement that Form 5500 be made available to participants and beneficiaries on request. However, PWBA's Division of Technical Assistance and Inquiries (DTAI), which responds to written and telephone inquiries from individuals who have complaints or problems regarding their employee benefit plans, has found that participants have not identified this as a problem.

E. Enforcement of Disclosure Requirements

Administrators are required, upon receipt of a written request of a participant or beneficiary, to furnish a copy of the latest SPD, and Form 5500. The administrator may make a reasonable charge to cover the cost of furnishing copies of these documents. If a plan administrator fails to comply with a participant or beneficiary's request to receive such information, within 30 days after the request, a court can assess a penalty against the administrator of up to $100 a day payable to the participant or beneficiary.

Documents required to be sent to participants and beneficiaries on request must also be made available for examination in the principal office of the administrator and in such other places as may be necessary to make available all pertinent information to all participants. Department of Labor regulations

require that the SPD disclose the right for participants and beneficiaries to view or request copies of additional information.

PWBA investigators routinely check for SPD, SAR, and annual report compliance, and when noncompliance is found appropriate enforcement action is taken that is merited under the circumstances. This includes assessment of civil penalties of up to $1,000 a day for failure to file a timely and complete an annual report.

III. Conclusion

I hope this information is helpful to you as the Committee considers reforms affecting the PBGC. I would be pleased to answer any questions that you may have.

The $810 represents the [redacted] Normal Annuity paid to you each month for the rest of your life. If you die within 60 months of starting payments, it is paid to your beneficiary for the balance of the 60 months.

You will also receive a temporary pre-Social Security benefit of $270 a month from the Plan until age 62 (see page 8). At age 62, the temporary pre-Social Security annuity stops and you may begin to receive payments from Social Security. If married, your spouse may also be eligible to receive a Social Security benefit beginning at age 62, increasing your monthly retirement income.

Example 3:

This example assumes retirement at age 55, 25 years of recognized service, average final pay of $2,000 a month and a Social Security benefit of $600 for a person age 62 at the time retirement occurs.

Step 1
1.6 percent x 25 years
x $2,000 x .75* =$600
*The early retirement reduction explained on page 8.

Step 2
1.5 percent x 25 years
x $600 x .75* =$169
*The early retirement reduction explained on page 8.

Step 3
Subtract $169 from $600 =$431

This $431 represents the [redacted] Normal Annuity paid to you each month for the rest of your life. If you die within 60 months of starting payments, it is paid to your beneficiary for the balance of the 60 months.

You also receive a temporary pre-Social Security annuity of $169 a month from the Annuity Plan until age 62. At age 62, this pre-Social Security annuity stops and you may begin to receive payments from Social Security. If married, your spouse may also be eligible to receive a Social Security benefit beginning at age 62, increasing your monthly retirement income.

INSURED BENEFITS

Benefits under this Plan are insured by the Pension Benefit Guaranty Corporation (PBGC) if the Plan terminates. Generally, the PBGC guarantees most vested normal retirement benefits, early retirement benefits, and certain disability and survivor's pensions. However, PBGC does not guarantee all types of benefits under covered plans, and the amount of benefit protection is subject to certain limitations.

The PBGC guarantees vested benefits at the level in effect on the date of Plan termination. However, if a Plan has been in effect less than five years before it terminates, or if benefits have been increased within the five years before Plan termination, the whole amount of the Plan's vested benefits or the benefit increase may not be guaranteed. In addition, there is a ceiling on the amount of monthly benefit that PBGC guarantees, which is adjusted periodically.

For more information on PBGC insurance protection and its limitations, contact the office administering your benefits or the PBGC. Inquiries to the PBGC should be addressed to the Office of Communications, PBGC, 2020 K Street, N.W., Washington, D.C. 20006. The PBGC Office of Communications may also be reached by calling (202) 254-4817.

FOR YOUR INFORMATION

This section contains technical information about the Benefit Plan and identifies its Administrators and Trustees. It also contains a summary of your rights with respect to the Plan and instructions about how you can submit an appeal if your claim for benefits is denied.

If you would like a copy of the formal Plan documents, write the Administrator-Benefits. The law provides that your employer may charge a reasonable fee (up to 25 cents per page) for duplicating these documents.

Sample Summary Annual Report Statement

REGS. cont'd Reg. §2520.104b-10(d)(3)

Minimum Funding Standards

[If the plan is a defined benefit plan:]

An actuary's statement shows that (enough money was contributed to the plan to keep it funded in accordance with the minimum funding standards of ERISA) (not enough money was contributed to the plan to keep it funded in accordance with the minimum funding standards of ERISA. The amount of the deficit was $).

[If the plan is a defined contribution plan covered by funding requirements]:

(Enough money was contributed to the plan to keep it funded in accordance with the minimum funding standards of ERISA) (Not enough money was contributed to the plan to keep it funded in accordance with the minimum funding standards of ERISA. The amount of the deficit was $).

Your Rights to Additional Information

You have the right to receive a copy of the full annual report, or any part thereof, on request. The items listed below are included in that report: [*Note*—list only those items which are actually included in the latest annual report]

1. an accountant's report;
2. assets held for investment;
3. fiduciary information, including transactions between the plan and parties-in-interest (that is, persons who have certain relationships with the plan);
4. loans or other obligations in default;
5. leases in default;
6. transactions in excess of 3 percent of plan assets;
7. insurance information including sales commissions paid by insurance carriers; and
8. actuarial information regarding the funding of the plan.

To obtain a copy of the full annual report, or any part thereof, write or call the office of (name), who is (state title: e.g., the plan administrator), (business address and telephone number). The charge to cover copying costs will be ($) for the full annual report, or ($) per page for any part thereof.

You also have the right to receive from the plan administrator, on request and at no charge, a statement of the assets and liabilities of the plan and accompanying notes, or a statement of income and expenses of the plan and accompanying notes, or both. If you request a copy of the full annual report from the plan administrator, these two statements and accompanying notes will be included as part of that report. The charge to cover copying costs given above does not include a charge for the copying of these portions of the report because these portions are furnished without charge.

You also have the legally protected right to examine the annual report at the main office of the plan (address), (at any other location where the report is available for examination), and at the U.S. Department of Labor in Washington, D.C., or to obtain a copy from the U.S. Department of Labor upon payment of copying costs. Requests to the Department should be addressed to: Public Disclosure Room, N4677, Pension and Welfare Benefit Programs, Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C. 20216.

(4) Form for Summary Annual Report Relating to Welfare Plans.

Summary Annual Report for (name of plan)

This is a summary of the annual report of the (name of plan, EIN and type of welfare plan) for (period covered by this report). The annual report has been filed with the Internal Revenue Service, as required under the Employee Retirement Income Security Act of 1974 (ERISA).

[If any benefits under the plan are provided on an uninsured basis:] (Name of sponsor) has committed itself to pay (all, certain) (state type of) claims incurred under the terms of the plan.

[If any of the funds are used to purchase insurance contracts].

Chairman PICKLE. Thank you, Mr. Lebowitz.

I don't want to get into a lot of questions, but in your last statement, you said that if noncompliance is found applicable, you can enforce some of these civil penalties. Have you ever assessed a penalty for failure to notify participants? Has the Department of Labor ever done that?

Mr. LEBOWITZ. The statute has a number of different sanctions for failure to comply with the reporting and disclosure provisions or notification provisions. The sanctions that apply in the case of failure of a plan administrator to provide documents on request is not one that we can enforce. It is one that the participant enforces himself or herself and can seek the fine, the $100 a day fine, through court action.

We have specific enforcement authority under section 502(c)(2) for failure to file a complete or accurate annual report on form 5500, and we have been very active in enforcing the law's requirements under that provision.

Chairman PICKLE. I don't want to belabor this, but I find your answer very general and not satisfying to me. I wish you would give our committee more information as we follow through on this testimony this morning, or later. I don't know of any penalty you have ever assessed for failure to notify participants, and I want to know specifically if you have.

I also want to thank you, Mr. Lebowitz, and Secretary Reich for appointing a task force to actively get involved. The Secretary called me to tell the committee that he was actually going to actively involve himself and the department, as well as the other agencies affected, in trying to find a solution because there is a problem and something needs to be done. So I express my personal appreciation for this individual commitment to try to correct some of the problems in our pension programs.

We have a lot of other questions, but I want to go on with our testimony of other witnesses.

Our next witness will be Mr. Randolf Hardock, representing the Department of the Treasury. Mr. Hardock, if you will proceed?

STATEMENT OF RANDOLF HURST HARDOCK, OFFICE OF TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. HARDOCK. Mr. Chairman, members of the subcommittee, I am pleased to be here today to present the views of the Department of the Treasury on certain issues relating to the PBGC and pension plan underfunding. My testimony will describe current tax rules regarding defined benefit pension plan funding and address the issues raised in the subcommittee's letter of invitation to testify.

Since the passage of ERISA in 1974, the Internal Revenue Code has contained minimum funding requirements that apply to all defined benefit pension plans. By requiring employers to set aside a minimum amount of assets in a trust for the benefit of their employees, the minimum funding requirements help ensure that employees' future pension payments are not contingent on the continued existence and profitability of their employer.

The minimum funding requirement is based on an actuarial projection of the future benefit payments from the plan. This projec-

tion is based on assumptions about interest rates, mortality, employment terminations, and, if applicable, future salaries. The portion allocated to the employee's past service is known as the "accrued liability," and the portion allocated to the current year is known as the "normal cost."

The annual minimum funding requirement varies from normal cost for several reasons. For example, a new plan within an accrued liability and no assets has an unfunded accrued liability that must be funded over no more than 30 years. If a plan's benefits or assumptions are changed, any resulting additional liability must be amortized over 30 or 10 years, respectively. In addition, any actuarial gains or losses must be amortized over 5 years.

In addition to the minimum funding requirements, employer contributions to pension plans are also affected by the Internal Revenue Code deduction rules. The deduction rules effectively limit the maximum amount of contributions to a plan. In general, the deduction limit for each year is the normal cost plus 10-year amortization of any unfunded accrued liability. Other deduction limits also apply.

By 1987, it became apparent to policymakers that the ERISA minimum funding system was not working perfectly. Too many plans were inadequately funded, which put employees and the PBGC at risk.

As a result of your leadership, Mr. Chairman, and the efforts of this subcommittee, several changes were made to the Internal Revenue Code as part of the Pension Protection Act of 1987. The changes were generally designed to improve the funding of underfunded plans.

First, the Pension Protection Act tightened the standards for the selection of actuarial assumptions. Assumptions must now be individually reasonable. Prior to the 1987 changes, those assumptions only had to be reasonable in the aggregate. The amortization periods for gains and losses and for changes in assumptions were also shortened.

Second, the Pension Protection Act added a deficit reduction contribution rule. For large employers who maintain a defined benefit plan where assets are less than current liability, additional contributions were required. Current liability was intended to approximate the liability for benefits upon plan termination. The interest rate used in the calculation must be within a specified permissible range.

The deficit reduction contribution integrates with the regular minimum funding rules. This is accomplished by substituting the deficit reduction contribution for the amortization of certain components of unfunded accrued liability. In calculating the deficit reduction contribution, a plan that had an unfunded current liability as of the 1989 plan year must amortize that preexisting liability over an 18-year period. If a plan has unfunded current liability that is not attributable to the preexisting liability, the deficit reduction rule requires the funding of that liability over a shorter number of years, typically ranging from 4 to 13 years. The number of years is determined by a variety of factors, including the plan's current funded status and whether the additional liability results from an unpredictable contingent event benefit, such as a plant shutdown.

Third, since ERISA, the Internal Revenue Code has permitted an employer to apply for a temporary waiver of the minimum funding requirements. As part of the 1987 changes, as Mr. Slate emphasized, the availability of waivers was limited.

Fourth, in order to encourage sponsors to improve funding in underfunded defined benefit plans, the Pension Protection Act added a special deduction rule that generally allows a large employer to contribute and deduct any amount necessary to bring the assets of the plan up to the level of current liability.

Finally, the Pension Protection Act added a security requirement for plans that are substantially underfunded. If a plan's assets are less than 60 percent of current liability, security must be posted for any benefit improvement.

The subcommittee has asked whether the current tax policy relating to defined benefit plans continues to make sense, especially for underfunded plans.

The issue presented is a complex one because of the need to balance many competing interests. These include the interest of employees in having adequate and secure pension benefits, the PBGC's interest in minimizing losses upon termination of underfunded plans, the interest of plan sponsors in minimizing contribution requirements, the desire of plan sponsors with well-funded plans to avoid escalating PBGC premiums, and the national interest in reducing the budget deficit and minimizing the potential burden on taxpayers.

We would note that the current funding rules appear to have worked well for the vast majority of defined benefit pension plans. Most employers have adequately funded their plans on the basis of the current tax rules. As of 1991, the PBGC has estimated that the average medium and large plan had assets equal to 117 percent of plan termination liabilities, and that about 75 percent of all participants in defined benefit plans were in plans that had assets in excess of plan termination liability.

However, the current funding rules may not have worked so well in some other cases. There is a small minority of employers that sponsor pension plans with a large amount of the underfunding and the attendant risk to the PBGC. PBGC has estimated that over 60 percent of the current underfunding that it insures is concentrated in a very small number of companies. The deficit reduction contribution was intended to improve that situation, but there is a possibility that more change is needed.

One way of reducing the PBGC's exposure would be to mandate faster funding for certain types of underfunded plans. Although it may be theoretically desirable to accelerate the funding of underfunded plans, such a change might also have negative consequences that will have to be taken into consideration. For example, one might not want to unduly increase the contribution burden on businesses that are having difficulties in meeting their cash flow requirements. In addition, one would need to address the revenue costs associated with increased deductible contributions.

As Mr. Slate has indicated, the administration has established an interagency working group to explore various issues relating to the PBGC and its exposure to underfunded plans. The Treasury Department has been taking an active role in that working group.

One of the goals is to develop policy options and to analyze the effectiveness of those options in improving the long-term financial status of the PBGC. We anticipate that ongoing efforts to improve modeling and analysis capabilities could be helpful in this process.

The subcommittee has asked for our recommendations to address the fact that some plan sponsors continue to contribute to well-funded plans for some of their employees, while plans covering other employees are severely underfunded. The subcommittee noted that the well-funded plans tend to be plans for executives and salaried employees, while primarily hourly employees participate in the poorly funded plans. Generally, the difference in funding status of these plans is a result of funding rules that differ depending on whether a plan's benefits are based on an employee's pay at retirement. If an employee's benefits depend on the employee's pay level at retirement, the minimum funding rules require the use of a salary increase assumption in order to anticipate the future benefit level. This results in a built-in safety margin in funding above the plan termination liability, which is based on current pay.

However, if an employee's benefits do not formally depend on final pay, but depend on future amendments to the plan, as is usually the case in collective bargaining situations, the same rules generally do not permit the projection of any such amendments that have not yet occurred. Consequently, these types of plans generally do not accumulate assets in excess of current liability. In the absence of a safety margin, benefit improvements will cause a plan to become temporarily underfunded after the amendment. If there are a series of benefit improvements, the plan is perpetually underfunded. This is one of the issues that the interagency working group will be focusing on.

The subcommittee has also asked for a description of the administration's concerns with the PBGC's current operations and solvency. Mr. Slate has already addressed those issues in detail on behalf of the administration.

Mr. Chairman, members of the subcommittee, that completes my formal statement. I will be pleased to answer any questions.

[The prepared statement follows:]

71-618 - 93 - 3

STATEMENT OF
RANDOLF HURST HARDOCK
OFFICE OF TAX POLICY
DEPARTMENT OF TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to present the views of the Department of the Treasury on certain issues relating to the Pension Benefit Guaranty Corporation (PBGC) and pension plan underfunding. My testimony will describe current tax rules regarding defined benefit pension plan funding and address the issues raised in the Subcommittee's letter of invitation to testify.

Current funding rules that apply to all defined benefit plans

Since the passage of the Employee Retirement Income Security Act of 1974 (ERISA), the Internal Revenue Code has contained minimum funding requirements that apply to all defined benefit pension plans. These minimum funding rules serve as a floor on employers' contributions to their pension plans. By requiring employers to set aside a minimum amount of assets in a trust for the benefit of their employees, the minimum funding requirements help ensure that employees' future pension payments are not contingent on the continued existence and profitability of their employer.

The minimum funding requirement is based on an actuarial projection of the future benefit payments from the plan. This projection is based on assumptions about interest rates, mortality, employment terminations and, if applicable, future salaries. The future benefit payments are discounted and the total present value is allocated over the years of an employee's service, using an actuarial method chosen by the employer that is generally designed to produce a smooth pattern of contributions throughout an employee's career. The portion allocated to the employee's past service is known as the "accrued liability" and the portion allocated to the current year is known as the "normal cost".

In theory, if a newly established plan has no allocation of liabilities to past service, the plan terms and actuarial assumptions never change, and the actuarial assumptions are always exactly correct, the plan's normal cost is the annual minimum funding requirement under the Internal Revenue Code. However, in practice, the annual minimum funding requirement varies from normal cost for several reasons. For example, a new plan with an accrued liability and no assets has an "unfunded accrued liability" that must be funded over no more than 30 years. Similarly, if a plan's benefits or actuarial assumptions are changed, any resulting additional liability must be amortized over 30 or 10 years, respectively. In addition, as part of the annual actuarial valuation, the plan's unfunded accrued liability is compared with the expected value of the unfunded accrued liability. Any resulting difference (known as an actuarial gain or loss) must be amortized over 5 years.

In addition to minimum funding requirements, employer contributions to pension plans are also affected by the Internal Revenue Code deduction rules. The deduction rules effectively limit the maximum amount of contributions to a plan. In general, the deduction limit for each year is the normal cost plus 10-year amortization of any unfunded accrued liability. In addition, the "full funding limitation" generally precludes deductible contributions that would cause the plan's assets to exceed the accrued liability as of the end of the year. Other deduction limits also apply.

Additional rules that apply to large underfunded plans and other recent funding reforms

By 1987, it became apparent to policymakers that the ERISA minimum funding system was not working perfectly. Too many plans were inadequately funded, which put employees and the PBGC at risk. Several changes were made to the Internal Revenue Code as part of the Pension Protection Act of 1987. The changes were generally designed to improve the funding of underfunded plans.

First, the Pension Protection Act tightened the standards for the selection of actuarial assumptions. Actuarial assumptions now must be individually reasonable, whereas the assumptions only had to be reasonable in the aggregate prior to the 1987 changes. In addition, the amortization periods for actuarial gains and losses or changes in actuarial assumptions were shortened.

Second, the Pension Protection Act added a "deficit reduction contribution" rule. For large employers who maintain defined benefit plans where assets are less than "current liability", additional contributions were required. Current liability was intended to approximate the liability for benefits upon plan termination. The interest rate used in the calculation must be within a specified permissible range.

The deficit reduction contribution integrates with the regular minimum funding rules. This is accomplished by substituting the deficit reduction contribution for the amortization of certain components of unfunded accrued liability. In calculating the deficit reduction contribution, a plan that had an unfunded current liability as of the 1989 plan year (i.e., pre-existing liability) must amortize the pre-existing liability over an 18-year period beginning in 1989. If a plan has unfunded current liability that is not attributable to the pre-existing liability, the deficit reduction rule requires the funding of the unfunded liability over a shorter number of years, typically ranging from 4 to 13 years. The number of years is determined by a number of factors, including the plan's current funded status and whether the additional liability results from an unpredictable contingent event benefit, such as a plant shutdown.

Third, since ERISA, the Internal Revenue Code has permitted an employer to apply for a temporary waiver of the minimum funding requirements. As part of the 1987 changes, the availability of waivers was limited, the required repayment period for waived contributions was shortened, and security was required for certain large waivers.

Fourth, in order to encourage sponsors to improve funding in underfunded defined benefit plans, the Pension Protection Act added a special deduction rule that allows a large employer to contribute and deduct any amount necessary to bring the assets of the plan up to the level of current liability.

Finally, the Pension Protection Act added a security requirement for plans that are substantially underfunded. If a plan's assets are less than 60 percent of the plan's current liability, a bond or similar security must be posted for any benefit improvement. The required security generally is the amount necessary to bring the plan's assets to 60 percent of the current liability, after taking into account the benefit improvement (or, if lesser, the amount of the liability for the post-1987 amendment).

<u>Current tax policy relating to defined benefit plan funding</u>

The Subcommittee has asked whether the current tax policy relating to defined benefit plans continues to make sense, especially for underfunded plans. We are currently evaluating that issue.

The issue presented is a complex one, particularly because of the need to balance many competing interests. These include: the interest of employees in having adequate and secure pension benefits, the PBGC's interest in minimizing losses upon termination of underfunded plans, the interest of plan sponsors in minimizing contribution requirements, the desire of plan sponsors with well-funded plans to avoid escalating PBGC premiums, and the national interest in reducing the budget deficit and minimizing the potential burden on taxpayers.

We would note that the current tax funding rules appear to have worked well for the vast majority of defined benefit pension plans. Most employers have adequately funded their plans on the basis of the current tax rules. As of 1991, the PBGC has estimated that the average medium and large plan had assets equal to 117 percent of plan termination liabilities, and that approximately 75 percent of all participants in defined benefit plans were in plans that had assets in excess of plan termination liability.

However, the current funding rules may not have worked so well in some other cases. There is a small minority of employers that sponsor pension plans with a large amount of the underfunding and attendant risk to the PBGC. The PBGC has estimated that over 60 percent of the current underfunding that it insures is concentrated in a very small number of companies. The deficit reduction contribution was intended to improve the situation, but there is a possibility that more change is needed.

One way of reducing the PBGC's exposure would be to mandate faster funding for certain types of underfunded plans. Although it may be theoretically desirable to accelerate the funding of underfunded plans, such a change might also have negative consequences that will need to be taken into consideration. For example, one might not want to unduly increase the contribution burden on businesses that are having difficulties in meeting their cash flow requirements. In addition, one would need to address the revenue costs associated with increased deductible contributions.

The Administration has established an interagency working group to explore various issues relating to the PBGC and its exposure to underfunded plans. The working group is still in the preliminary stages of its work. One of its goals is to develop policy options and analyze the effectiveness of those options in improving the long-term financial status of the PBGC. We anticipate that ongoing efforts to improve modelling and analysis capabilities could be helpful in this process.

<u>Overfunded and underfunded plans</u>

The Subcommittee has asked for our recommendations to address the fact that some plan sponsors continue to contribute to well-funded plans for some of their employees while plans covering other employees are severely underfunded. The Subcommittee noted that the well-funded plans tend to be plans for executives and salaried employees, while primarily hourly employees participate in the poorly-funded plans. Generally, the difference in funding status of these plans is a result of funding rules that differ depending on whether a plan's benefits are based on an employee's pay at retirement. If an employee's benefits depend on the employee's pay level at retirement, the minimum funding rules require the use of a salary increase assumption in order to anticipate the future benefit level. This results in a built-in safety margin in funding above the plan termination liability (which is based on current pay).

However, if an employee's benefits do not formally depend on final pay, but depend on future amendments to the plan, as is usually the case in collective bargaining situations, the same rules generally do not permit the projection of any such amendments that have not yet occurred. Consequently, these types of plans generally do not accumulate assets in excess of current liability. In the absence of a safety margin, benefit improvements will cause a plan to become temporarily underfunded after the amendment. If there are a series of benefit improvements, the plan is perpetually underfunded. This is one of the issues that the interagency working group will be focusing on.

<u>PBGC solvency</u>

The Subcommittee also has asked for a description of the Administration's concerns with the PBGC's current operations and solvency. I understand that you will have other Administration witnesses this morning who will discuss these issues in detail.

Mr. Chairman, Members of the Subcommittee, that completes my formal statement. I will be pleased to answer any questions that you may wish to ask.

* * * * *

Chairman PICKLE. Thank you, Mr. Hardock. I think that we will have more specific questions as we go along, but I appreciate your testimony.

Now, this completes the statements. I assume none of you other individuals want to make additional statements at this point. The Chair then will first recognize Mr. Kleczka for any questions.

Before you start, I want to say this: I found your statements very interesting, but very general. I don't think they pinpoint the problems that we actually face. I hope that the questions we have as we follow through this morning from the members will help us get that picture more clearly in mind.

Mr. Kleczka?

Mr. KLECZKA. Thank you, Mr. Chairman.

First of all, let me welcome Mr. Slate and wish you the best in your new endeavor. Chairman Pickle has been working on this PBGC problem for years. I think he has correctly indicated there are serious problems ahead. He has repeatedly introduced legislation, as he has this session, to help cure some of the problems, and I view those efforts as trying to act on a situation that is getting worse and not react when things actually blow up.

So I look forward to the task force, but my question is: When do you envision the task force completing some recommendations? Legislation introduced by the chairman is ready to go. I would hate to see an elongated period of time where we can get the recommendations of yourself and the Labor Department and others while the PBGC deteriorates any further.

Mr. SLATE. As we indicated, sir, we share your concern, we share Mr. Pickle's concern, and we are looking for a solution for the long term.

It is my preliminary assessment that to develop a solution for the long term, we need to work intensively over the next few months to sort out the many issues.

Mr. KLECZKA. What type of timetable?

Mr. SLATE. We need to sort out the many issues and the competing considerations and to reach out to all those with a stake in the process so we can come forward with an effective solution while the situation is still manageable. For my part, anyway, sir, I think we would aim for September.

Mr. KLECZKA. OK. I was quite surprised at the testimony from Mr. Hardock. At the last hearing this committee had on the issue, we found that there are about 50 very large corporations with seriously underfunded plans. We found that, for the most part, these were the concerns which were giving some sizable benefit increases even though they were totally unfunded. And if you had come forward and said that the bulk of the plans are overfunded and looking good, the data that we looked at a few months ago indicated the opposite. And I am assuming you are aware of the hearing. I don't know if you looked at any of the testimony we received.

Could you respond to the fact that we looked at 50 real bad actors who are causing some real problems for the fund, and mesh that with your argument that everything is rosier than we had anticipated?

Mr. HARDOCK. I think if you focus on the 50—and I think it is a worthwhile exercise to focus on the 50——

Mr. KLECZKA. Well, these are the large, large corporations.

Mr. HARDOCK. There are over 65,000 plans, and most of those plans, including the large and medium size plans, are funded in excess of termination liability.

If you look at the list of 50—and the task force has been looking at the companies on that list and companies off that list—some of them are in industries where there isn't a particularly great risk. Perhaps there were recent benefit increases. Others are items of concern and are items that the task force intends to look at closely.

Mr. KLECZKA. Well, is it not true that PBGC is currently running at a deficit?

Mr. HARDOCK. With respect to plans that have currently terminated and PBGC has taken over those plans, there is a deficit.

Mr. KLECZKA. What is the amount?

Mr. HARDOCK. $2.5 billion, I believe. Mr. Slate?

Mr. SLATE. $2.7 billion.

Mr. HARDOCK. $2.7 billion.

Mr. KLECZKA. OK. So the plan is already running at a deficit of $2.7 billion, and you are indicating that everything is looking good.

Mr. HARDOCK. I don't believe there is anything in the statement that indicates——

Mr. KLECZKA. Those are my words, not yours. OK.

As the task force meets, there are a couple things I would like you folks to look at. Hopefully we will also amend the chairman's bill to provide some resolve for this. But we had a situation where Allis Chalmers' hourly plan went to the PBGC, and these folks received an estimated payment for a period of years. And I am trying to recall exactly how long, but it could be some 3 to 5 years. And now a reconciliation has occurred, and many, many of the pensioners have found themselves in a payback situation. And so after this elongated period of time, now they find out they were overpaid for a period of years, and now they are going to have to pay back, either on a monthly basis or in a lump sum, to the PBGC the overpayment. I don't think any of the pensioners dispute the fact that if they are overpaid they should pay it back, but what concerns them is that the elongated period of time—and I am talking years and years—before somebody sat down and did the calculation.

Then there is another problem with the PBGC law inasmuch as if you take the monthly payback, you will pay it for life even though you might fully pay back the overage shorter than, you know, you paying until you actually pass away. And this has many of the pensioners from Allis Chalmers very irritated. They, again, have no problem paying back the total amount due, but the law provides that you will pay it back for life whether or not you have fully satisfied your liability and now you are paying back in excess of that.

Mr. Slate, maybe you can respond to that and indicate, or Ms. Flowe, if you plan to look at that.

Mr. SLATE. Let me respond generally, sir, and then let counsel respond specifically to that case. Let me say that I am very interested in not only benefit protections from a policy point of view, but in actual day-to-day service. And that was certainly one of the charges that Mr. Reich read to me loud and clear when he asked me to take this job.

Anytime there is an elongated period from the time a plan terminates until benefits are received, it is likely to be painful, and as you say, it is likely to create mistakes and misunderstandings and so forth. That is going to be something that we are going to have to work on and I would like to keep you posted on.

Now, as far as Allis Chalmers goes, perhaps Ms. Flowe can respond.

Ms. FLOWE. It is the case that took a number of years. It wasn't really a matter, however, of people not getting around to it. It was that we found some pretty serious data and record problems in that case in terms of being able to process it. There is also the fact that our program, unfortunately, is very complex; and when you combine the lack of data and good records, as we did in this case, with the complexity of trying to overlay our guarantee structure on the plan document, unfortunately it can take a very long time. We felt bad about that.

Mr. KLECZKA. Can you address the fact that these folks will have to pay back whatever amount is prescribed for life even though they might have repaid it prior to passing on?

Ms. FLOWE. As I understand it, that is simply a function of the operation of our recoupment policy, which is what it is called, the recoupment policy.

Mr. KLECZKA. Is that fair?

Ms. FLOWE. It is the way the rule works, and I am afraid I can't really describe it in much more detail than that.

Mr. KLECZKA. Well, maybe we should change the law, because even an agency as large as Social Security, once an overpayment has been satisfied, we stop collecting from the individual.

Mr. SLATE. Let me say, sir, that one of the things that we are looking at on this task force is what I call, for lack of a better word, simplification. It really is rather amazing the way things are allocated between guaranteed and nonguaranteed and funded and nonfunded. And I think at the very least we could be doing people a service by making that clearer and simpler.

Mr. KLECZKA. OK. Ms. Flowe, would you also check and get back to the subcommittee or my office on the status of the Allis Chalmers salary plan? Recently there was an article in the Milwaukee newspapers relative to that plan having problems, and if you could give me any insight as to what is transpiring there, knowing full well that the hourly, the largest of the plans, already is in PBGC. Now we are hearing rumors that the salaried might be in the same situation.

Ms. FLOWE. Certainly. We will be happy to look into that and get back to your office.

Mr. KLECZKA. Thank you very much. Again, I look forward to the task force report, although I am sure that Congress can move on the chairman's bill. The longer we delay—that $2.7 billion deficit is not going to get any smaller, and it seems that some of the major employers—and we looked at the airline industries. They are giving out pension benefits like popcorn, and knowing full well that they are hollow promises, they are not funded promises, and I fear for where we might be going with this new type of corporate welfare.

Thank you.

Chairman PICKLE. Thank you, Mr. Kleczka.

Now the Chair recognizes Mr. Herger.

Mr. HERGER. Thank you very much, Mr. Chairman.

Just following up on some of the concerns of my colleague, is it correct that the current deficit of the PBGC is running in the vicinity of $2.7 billion?

Mr. SLATE. The PBGC is able to pay participant benefits. It will be able to pay benefits for as far as the eye can see.

On a projected basis, if you take the plans that have terminated and project the money that will have to be paid out over time and compare that with the assets, the deficit is $2.7 billion. It looks like it is going to grow, and that is why we have such a concern for the long term.

Mr. HERGER. The direction of this deficit is increasing, is it not more than double what it was just several years ago?

Mr. SLATE. I believe it would have, sir, because in the last few years there have been a few, but a few large, terminations that have added to the deficit.

Mr. HERGER. With this in mind, I would like to ask Mr. Slate what the philosophy is currently of the Clinton administration toward the role of the PBGC? For example, do you view the PBGC as primarily an insurance program which should follow actuarial principles or as a transfer payment, social type program?

Mr. SLATE. Let me answer the first question about the philosophy of the Clinton administration. I think as indicated by the speedy work of Professor Reich in terms of setting up the task force and, as Mr. Pickle pointed out, his own personal involvement, the philosophy of the Clinton administration is that protection of benefit expectations is of the highest priority.

Now, to your more specific question about what the PBGC is. Sometimes the question gets asked: Is it a pure insurance agency on the one hand, or on the other hand is it some sort of social agency? I think the answer is probably a bit of both.

If the people who passed the law in 1974 simply wanted to have this as an insurance agency, as a straight insurance agency, then they would have set us up as such; they maybe even would have given the account to one of the outside insurance companies. So, clearly, it is much more than a straight insurance agency. Our primary interest is benefit protection. However, a piece of that benefit protection is to make sure that you have a viable PBGC.

Mr. HERGER. My major concern and the reason we are having these hearings, Mr. Slate, is our concern over whether we will be able to meet the payments of those who are retiring in the future. I believe I am speaking for the vast majority of the American people who are saying we have had enough of the S&Ls, we have had enough of Government continuing to promise more than they are able to pay, with somewhere down the line perhaps our children or grandchildren being the ones who are going to end up footing the bill. Many of us feel that those are irresponsible decisions that we are making now. If I hear you correctly, you are saying that the move or at least the philosophy of this administration is that this is not a program that we are going to work on what we consider out in the free market system, out in the "real world" of having a sound actuarial run program. Is that correct?

Mr. SLATE. No, sir. I think we share your concern. The PBGC has a deficit. It is growing, and I think we are striving mightily to find a solution for the long term.

Mr. HERGER. Striving mightily, does that mean that we are going to make this into a sound program?

Mr. SLATE. Yes, sir. I think the major goal of the administration, the Secretary, and me is to make it a sound program because our primary interest is benefit protection, and as part of benefit protection, you have to have a viable PBGC.

Mr. HERGER. I am very pleased to hear that. Do we have some timeframe when you think you will have this recommendation of how to do just what you have said?

Mr. SLATE. Well, again, sir, this is only my own preliminary personal assessment, but my sense is that we should use the next few months to work intensively to review and balance the competing considerations, and to reach out to all those people with a stake in the process. In that way we can address the long-term problem while it is still manageable. And as I indicated, I think September would be a good date for us to aim.

Mr. HERGER. Well, I thank you for that. I have just a followup question on that, in an area with the background of what we have just been talking about. On January 29, 1991, the Washington Post reported the growing movement within the administration to implement President Clinton's campaign proposal to tap the Nation's pension funds for infrastructure projects. The proposal calls on pension plans to invest $30 billion in public works projects. Could you tell me how you think a program such as this would affect the financial condition of the pension system?

Mr. LEBOWITZ. Congressman, I am not specifically aware of what the proposal was that the article relates to.

Mr. HERGER. I have a copy of this Washington Post. The headline is "Panel Endorses Clinton's Vision of Tapping Nation's Pension Funds." That is the headline here. Again, it is from January 29.

In light of what we are talking about, can you give us a further vision of what the President and the administration, what their actions are intended to be, and how you feel this would affect this pension system?

Mr. LEBOWITZ. What I can say is to comment to this effect: Secretary Reich spoke to a group called the Council of Institutional Investors just a couple of weeks ago, a group made up of very large private sector and public sector pension fund managers, and in that speech he made it clear that he believed that it was extremely important that those with responsibility for managing pension funds, for investing pension funds, adhere to the standards in ERISA, to the fiduciary standards and the very important protections in ERISA.

I think there are a lot of people who have a lot of ideas about how pension funds can be invested and might be invested in a more productive way, perhaps, from their point of view than has been the case in the past. But there hasn't been any assertion from the department that the fundamental provisions of ERISA, the safeguards and standards of ERISA, should be compromised at all.

Chairman PICKLE. Would the gentleman yield?

Mr. HERGER. Certainly.

Chairman PICKLE. I am concerned about your answer, Mr. Lebowitz, but I think it more appropriately might go to Mr. Hardock. The administration has included $2.9 million for an underfunded pension plan study. That appropriation will fall probably under your and IRS's jurisdiction. What will be accomplished by the appropriation of these funds if they are given?

Mr. HARDOCK. The additional appropriations would be used to expand an ongoing IRS study of the causes and effects of underfunding. We hope that the information derived from that proposal will improve the enforcement capability of the IRS in ensuring that funding contributions are made. It also may provide some data that will be helpful to the working group.

Chairman PICKLE. The General Accounting Office has found that plans are not complying with the funding requirements in the 1987 Act. Is that correct?

Mr. HARDOCK. We have not developed any data that I am aware of.

Chairman PICKLE. Well, the General Accounting Office is going to testify later, and I think that will be their testimony.

Now, since they have made a finding of fact that the law is not really being complied with, then the specific question is: What will you do with this money? The law is not being enforced properly. If you got this money, it will give you the money to enforce it. Is that correct?

Mr. HARDOCK. This provides money to hire additional employees to begin the process of compiling information to study the issue further. I think we can get back to you with more detail on that particular program, if that would be helpful to the subcommittee.

Chairman PICKLE. Well, I would like for you to do that, and perhaps here in this hearing today. I want to know what you have found in the way of a specific finding that would cause you to ask for this money. I would like to know what percentage overall the plans funding obligations are not being enforced, not meeting the minimum funding requirements, and I would like to know how you are going to target this money specifically. If there is money being asked for, that must be a clear indication that the administration feels that there is a definite problem out there and they are willing to give $2.9 million more just to help study and enforce it. Now, I want to know what your plans are, so I would ask you to submit that for this committee.

[The following was subsequently received:]

DEPARTMENT OF THE TREASURY
WASHINGTON

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Ways and Means
Subcommittee on Oversight

The Honorable J.J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Pickle:

On April 20, the Subcommittee on Oversight of the Committee on Ways and Means held a hearing to review the administration and operations of the Pension Benefit Guaranty Corporation at which I testified on behalf of the Department of the Treasury.

At that hearing, you addressed questions to me regarding a budget proposal request for $2.9 million for the Internal Revenue Service to study underfunded pension plans. Specifically, the questions raised were:

1. What specific problems has the Internal Revenue Service found that led to the appropriation request?

2. How would the additional funds be used?

3. What percentage of plans are not meeting the minimum funding standards in the Internal Revenue Code?

Since these questions relate specifically to Internal Revenue Service matters, I have directed your inquiries to John Burke, Assistant Commissioner (Employee Plans & Exempt Organizations). He will provide you with the requested information.

Let me take this opportunity to thank you for your invitation to appear before the Subcommittee. We look forward to continuing to work with you and the other Members of the Subcommittee on issues surrounding the Pension Benefit Guaranty Corporation.

Sincerely,

Randolf Hurst Hardock
Office of Tax Policy

cc: John Burke

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

ASSISTANT COMMISSIONER
(EMPLOYEE PLANS AND
EXEMPT ORGANIZATIONS)

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1993

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Pickle:

The Office of Tax Policy in the Treasury Department has asked us to respond to questions you posed on April 20, 1993, at your Subcommittee hearing reviewing the administration and operations of the Pension Benefit Guaranty Corporation (PBGC).

Your questions concerned our FY 1994 budget request for $2.9 million for the Underfunded Pension Plan Program.

First, you asked what specific problems has the Internal Revenue Service found that led to the appropriation request?

The scope of underfunding is increasing, but the extent and causes of underfunding are not clearly known. We know, for example, from the PBGC, that more underfunded pension plans terminated in 1992 than in the previous year, but losses from underfunded plans declined somewhat because of fewer new major terminations. The 1992 PBGC Annual Report indicates that this experience helps confirm a trend to terminations of larger plans and rapidly growing losses. For the years 1987 to 1992, net losses from single employer pension plans ($2,259M) exceeded the losses for the prior six years ($1,545M) by nearly 50 percent and were ten times greater than the losses for the first six years of PBGC's operation ($228M).

We also know from our experience in considering requests for waivers of the minimum funding standards that some large plan sponsors are having difficulty adequately financing their defined benefit pension plans. More generally, interest rates have declined, thus increasing the present value of benefits (pension plan liabilities), and returns on investments in some categories of assets, particularly real estate, have been poor.

As you know, the Service, the PBGC and the Department of Labor share responsibility for examining and regulating pension plans. The Service has the sole responsibility for interpreting and enforcing the minimum funding standards. As such, we are in the unique position, through our examination programs, to collect detailed information about the actual implementation of the minimum funding standards, both to ascertain compliance with, and to make suggestions for improvements in, these standards.

IRS also has access to current information returns filed by the universe of pension plans (Form 5500 and Schedule B). Combining this data with financial information about the plan sponsors should enable us to deal more effectively with pension plans in danger of deterioration. Thus, we hope our programs will assist the PBGC which deals with plans only after a plan sponsor is already in serious financial trouble.

○ Second, you asked how the additional funds would be used?

The additional funds will be used to increase staffing devoted to the Underfunded Pension Plan Program in FY 94. We are concerned about the level of compliance of pension plans with existing minimum funding requirements and the problem of plans which would be underfunded if they were to be terminated.

Accordingly, we are taking steps to enhance our enforcement of existing law through training of our examiners and through improving our ability to select returns for examination. We are also conducting a formal study under the direction of an experienced pension economist to determine the extent and the causes of underfunding and methods for improving the situation. We expect to implement solutions beginning in FY 1995.

As part of the Underfunding Study, we have undertaken in-depth examinations of a statistical sample of some 400 large, underfunded, pension plans to determine specifically the nature of and causes for underfunding that may be present in those plans. A comprehensive checksheet and agent's guide have been prepared for use in conducting these examinations and to collect information about the plans. In addition, the pension economist is compiling data on trends in the universe of plans and plan sponsors.

We are also conducting enforcement examinations of some 2000 pension plans to ensure compliance with existing minimum funding standards and to perfect our selection of returns of plans having underfunding problems.

○ Finally, you asked what percentage of plans are not meeting the minimum funding standards of the Internal Revenue Code?

For the return year ending December 31, 1990, 1.5 % of plans that reported they were subject to the minimum funding standards, also reported not meeting the standards. Thus, of 23,966 filers of the Form 5500 (plans with 100 or more participants) subject to the minimum funding standards, 348 (1.5%) reported a minimum funding deficiency. There are smaller plans, from 1-100 participants, that also indicate minimum funding deficiencies.

It is important to note that plans reporting a funding deficiency on their Form 5500 or Schedule B for the first time may already be significantly underfunded. A pension plan may meet the minimum funding standards of section 412 of the Code yet be underfunded in a given year when the value of plan assets is less than the present value of accrued benefits under the plan. For large plans, this could include substantial past service liabilities. Prior to being unable to make required minimum funding contributions, plans may change actuarial assumptions, funding methods or use other means to reduce or eliminate their funding contributions.

Upon completion of the Underfunding Study, we will be able to give more precise information about the extent of the failure to meet minimum funding standards beyond the obvious problem of reported funding deficiencies.

We hope this information assists you in dealing with the significant issue of underfunding of pension plans. If you need any additional information, please call me at (202) 622-6710.

Sincerely,

John E Burke

John E. Burke

cc: Martin I. Slate
Executive Director, Pension Benefit Guaranty Corporation

Chairman PICKLE. I thank the gentleman for yielding. Were you through?

Mr. HERGER. Well, just following up, again, our purpose for being here is a concern of the American people whether or not somewhere down the line we are going to have unfunded pension plans that the American taxpayers are going to have to pick up. I personally represent a very large rural district that would love to see funding going into roads and infrastructure and the different projects—bridges, sewer systems, water systems—that were listed, at least in this article. My concern, though, is are we going to endanger this system even further than it already is? We have seen a budget deficit that in the last couple years since 1989 has gone from $1.1 billion to $2.7 billion, as far as from a sound actuarially funded system would be concerned. Investing this money into roads and bridges is something that I would like to see. However, I wonder how are those roads and bridges going to pay back the money when these retirees reach retirement age and are going to need this money again.

I am just curious. Where is that money going to come from?

Mr. LEBOWITZ. Congressman, there is——

Mr. HERGER. Should we go ahead with this proposal, which evidently the Clinton administration, at least as recently as January 29, was looking at very favorably?

Mr. LEBOWITZ. It may be that that article is reporting on the report issued by a commission that was established under last year's highway bill to look at ways of financing infrastructure. One of the things they looked at was ways of attracting pension funds into investments in infrastructure-related activities.

That report made the point—and I think Secretary Reich in his speech to the Council a couple of weeks ago has emphasized—that any investment alternative that plans might consider has to meet the basic standards of ERISA, the prudence and exclusive purpose, and the interest test. In other words, it has to make sense from a marketplace standpoint. So I hope that answers your question. There is no intention or inference on anybody's part that those standards are being compromised at all.

Mr. HERGER. Well, then, just following up, would you feel that it would be prudent to be investing this money, people's pension money, into roads, bridges, and sewer systems? Is this the type of investment that you, considering their pension funds, would put your money into?

Mr. LEBOWITZ. I think the question is really can those kinds of activities be financed in a way that provides an appropriate return, a marketplace-based return to investors, whether they be pension funds or any other kind of investors. If they can, then pension funds will invest in them. If they can't, then pension funds won't invest in them. Pension fund managers are driven by the marketplace, and the challenge is, for those who advocate those kinds of investments, to find ways to make these investments attractive. Nobody is inferring that plans in any way should sacrifice return or take on additional risk in order to finance these projects.

Mr. HERGER. Well, how is the bridge and how are the roads and the sewer system going to pay this back down the line when, again,

these people who are retiring are going to want that money? That is my question.

Mr. LEBOWITZ. A lot of public projects and semipublic projects, as you know——

Mr. HERGER. Is it the taxpayers who will pay it back?

Mr. LEBOWITZ [continuing]. Have cash flows, highways and turnpikes and other things that have an income stream of their own, and they are financed on the public markets. They obviously, if they are going to be financed on the public markets, have to have a rate of return that is commensurate with the risk and that the marketplace judges is adequate. And that is the standard that is going to apply.

Mr. HERGER. Well, I don't want to belabor this anymore. Again, I am looking forward to having bridges and roads built in my very large rural district. My concern, though, is where the financing is going to come from. I would question very seriously if pension funds are where it should come from, particularly when some day our grandchildren may have to foot the bill and pay this money back.

Thank you.

Chairman PICKLE. Thank you, Mr. Herger.

Now the Chair recognizes Mr. Brewster.

Mr. BREWSTER. Thank you, Mr. Chairman.

We have established the fact, according to some previous questions here, that PBGC currently runs a deficit of about $2.7 billion. We have also established that that deficit has increased from $1.1 billion in 1989, I believe, to $2.7 billion today, and that it is continuing to grow.

Is it true that there has been a decrease in the level of funding by sponsors of underfunded plans in recent years?

Mr. SLATE. Is it true that there has been a decrease in the level of funding?

Mr. BREWSTER. By sponsors of underfunded plans.

Mr. SLATE. Right. I have seen data—and it looks like pretty good data—that would suggest that. It is one of the things that the task force is looking into, both the trends and the causes.

Mr. BREWSTER. So that would indicate, then, that the deficit is going to continue to grow and get bigger at PBGC; am I correct?

Mr. SLATE. Well, ultimately, sir, much of the underfunding is in plans maintained by healthy corporations that, God willing, will never land on the PBGC. But with respect to the unhealthy corporations, which is a percentage that is also growing, that is the concern.

Mr. BREWSTER. Is it true that the underfunding increased by about $10 billion in 1992?

Mr. SLATE. I am not sure about 1992, sir. The data that I have seen is based on SEC filings that would culminate by the end of 1991. And as I indicated in my testimony, in real dollar terms over that 2-year period it increased by about $10 billion.

Mr. BREWSTER. The underfunding?

Mr. SLATE. Yes.

Mr. BREWSTER. The underfunding. That is what we are talking about.

Mr. SLATE. Yes.

Mr. BREWSTER. Is it true that some employers continue to amend their plans to increase their pension benefits even though they are not funding their past promises on those benefits?

Mr. SLATE. It would appear that that is so. We are certainly concerned about that. It is one of the focuses of the task force inquiry.

Mr. BREWSTER. OK. So if PBGC has to pick up additional costs, the administration then is going to come to Congress and say you have got to give us more money for PBGC, very much like the RTC or FDIC. Is that correct?

Mr. SLATE. I think that there is a long-term concern. That is why it is our judgment that we ought to develop a solution for the long term while it is still manageable. We don't want to end up with the kind of situation that you referred to.

Mr. BREWSTER. If we do end up with that, the people who have properly funded their pension plans in the past would be the ones who get hit with helping pick up the cost of those who are underfunded. Is that correct?

Mr. SLATE. Yes. And, again, that is why I think that we have to move forward while the situation is still manageable and we can bite it off in discrete bits and have legislation that moves with sensible steps. That is one of the real concerns as to why you want to develop a solution for the long term.

Mr. BREWSTER. Well, is there any reason to believe that things will change as far as underfunding of these plans without a change in the law?

Mr. SLATE. I don't want to get ahead of the task force, sir, but my personal assessment, as I said in my statement, is that the law itself is structured in a way that certainly leaves a lot of room for that deficit to grow.

Mr. BREWSTER. So without changing the law, in your personal opinion, not the task force's, it would probably continue to grow?

Mr. SLATE. In my personal opinion, it would probably continue to grow, but there is time to take the steps and to address those problems while the situation is still manageable.

Mr. BREWSTER. I don't really know which one to address this to, but is the administration willing to recommend limiting the ability of employers to increase benefits in plans that are already significantly underfunded?

Mr. SLATE. I think it is premature for me or anyone else to take that position. As I indicated to you, that fact of life is a concern.

Mr. BREWSTER. I happen to be one who believes the chairman's bill is very timely, that every time there are negotiations on future benefits out there, we get further in the hole, and that waiting until September might be a little long as far as doing something on this issue. So I would certainly encourage them to move promptly.

Is the administration considering options to address pension plan sponsors who underfund hourly plans and fully fund management plans?

Mr. SLATE. Yes. As Mr. Hardock indicated in his testimony, that is something that we are looking at and something that is certainly a concern.

Mr. BREWSTER. Thank you.

Chairman PICKLE. Now the Chair recognizes Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman.

Mr. SANTORUM. I was first.

Chairman PICKLE. The Chair does recognize Mr. Santorum, and I believe he was timely in presence. So, Mr. Santorum.

Mr. SANTORUM. Thank you.

Mr. Hardock, you said something that I am not too sure I understand correctly. You said that there is a study going on right now and you have asked for more money to study why companies are underfunding their pension plans. Now, you really didn't say that, did you? You really are studying why companies are underfunding their pension plans?

Mr. HARDOCK. Mr. Slate has worked on this issue during his time at the IRS, and I think we will let him address that.

Mr. SLATE. Let me address that. As I understand it, the study is to get some empirical data on what the day-to-day hands-on experience is of taxpayers who have defined benefit plans and must fund. In other words, they are reviewing a number of taxpayer situations and trying to find out on a very empirical basis where the soft spots and the strong parts might be.

Mr. SANTORUM. Can't you just look at the plans that are underfunded and determine that those people aren't paying their contributions? I mean, what study needs to be done here?

Mr. SLATE. Well, I think, as Mr. Hardock pointed out in his testimony, there are a lot of complex rules and there are a lot of considerations. And I think what the study is designed to do is to see whether people are following the law—and as I say, it is a complex law—and to the extent if they are not following it, what are the reasons, and if they are following it, whether there should be corrective action taken particularly with respect to underfunded plans.

Mr. SANTORUM. OK. You are making a lot of points here about holding off until September to do something about this problem that this subcommittee has been working on for some time, that the chairman has introduced legislation on in the past, that GAO has studied extensively, that CBO has studied extensively, that your own organization, the PBGC, has studied extensively in the prior administration. And now you are saying you are having intensive study, additional study, that is going to take 6 months—I guess maybe 7 months because I guess you started it in February or March, 7 months of additional study to figure out where we go and that you have no opinions on the chairman's bill because you wouldn't answer Mr. Brewster's question about the cash flow rule.

I take it you have no position on requiring underfunded pension plans to fund at least 90 percent of their current benefits before they grant any additional benefits, another aspect of the legislation. You have no opinion on that either?

Mr. SLATE. I think it would be premature for us to take a position. As I indicated, my opinion is that we are concerned about the overall question that the bill addresses. The bill represents a product of a lot of good thinking and a lot of food for thought; it is something that the task force is looking at very closely. We hope that we will be able to continue with the subcommittee to look at the bill.

Mr. SANTORUM. How intensive? I mean, do you meet once a week?

Mr. SLATE. No. I think it is more like 3 times a week for upwards of 2 hours, and then the staff works in between preparing materials and reacting and so forth. And as I indicated, right now we are meeting with congressional committees, with representatives of the congressional committees, and with outside groups, particularly representatives of unions and employers.

Mr. SANTORUM. Have you met with any other agencies, like CBO and GAO, who have worked on this before?

Mr. SLATE. I think that would be a very, very good suggestion, and I am glad that you made it.

Mr. SANTORUM. I believe that would be an obvious——

Mr. SLATE. Actually, we have had CBO, now that I think of it. But the answer is it would be a good suggestion to have the GAO. I know they are going to submit some very interesting material today.

Mr. SANTORUM. So you are not prepared here to discuss really anything in particular. You are just telling us that you are looking at it, and you will be back to us in a few months.

Mr. SLATE. Well, as a new administration, we need to take a fresh, comprehensive look at the situation, and——

Mr. SANTORUM. But you don't see this as something that is particularly urgent that we need to act on any time in the next year or so?

Mr. SLATE. Quite the opposite, sir. That is not what I am saying. I am saying that we need to develop a solution for the long term and that we need to sort out the many issues, to look at the competing considerations, and reach out to all those with a stake in the process and develop a solution for the long term while it is still manageable.

The administration is on the case, sir.

Mr. SANTORUM. OK, but you said yes, you are concerned about the long term. The question I had was on urgency. You don't see this—this is a straight question. You don't see this as anything that we really need to act on, as the chairman has suggested, in the reconciliation bill, that we have to do it some time this year, that things can wait, that we can wait until next year when the next opportunity comes to pass a similar bill?

Mr. SLATE. I am not prepared to extend the period out that long. I think we are working as hard as we can. As I indicated, we would aim for September to put together a solution for the long term.

Mr. SANTORUM. The chairman has indicated that there is a—I mean, there are windows of opportunities, as I am sure you understand, Mr. Slate. There are windows of opportunities in the legislative process. The chairman has identified, I think correctly, a window of opportunity. That window of opportunity doesn't match particularly well with your time frame.

Mr. SLATE. Well, I think we all give benefit protection the highest priority possible, and I hope that when a bill is submitted that we can work together to enact legislation.

Mr. SANTORUM. OK. Again, are you suggesting, then, that the committee move forward on its own and you may or may not support that effort?

Mr. SLATE. I can't advise the committee as to how to move. I can just tell you that anything that enhances benefit protection is something that everyone has to take seriously.

Mr. SANTORUM. And prior to September, if we did do some activity and we would submit it to you for comments, I would take it the administration would take some position on the bill?

Mr. SLATE. It is premature for me to say any of that. All I can tell you is that I hope that we can all work together.

Mr. SANTORUM. Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Hancock.

Mr. HANCOCK. I will try to be as brief as possible. I would like to get a little historical information into the record, if you would be kind enough.

Could you tell me how many qualified defined benefit plans are in effect right now; in other words, how many 5500 forms you get on an annual basis?

Mr. SLATE. We have a couple of approaches here.

Mr. LEBOWITZ. We can certainly provide the specific number for the record. I don't have it with me.

Mr. HANCOCK. Can you give me an approximation, then?

Mr. LEBOWITZ. Defined benefit plans of all——

Mr. HANCOCK. The defined benefit plan is what your organization is designed to guarantee.

Mr. SLATE. Let me—I know that our organization covers about 77,000 plans. Now, there are a number of defined benefit plans, sir, that either because of their size or particular composition aren't covered by the PBGC. But if you want to look at the——

Mr. HANCOCK. Like what, for instance——

Mr. SLATE. I think the number PBGC covered is slightly upward of 75,000.

Mr. HANCOCK. What type of defined benefit plans are you talking about that are not covered? Are you talking about the Government employee pension plans?

Mr. SLATE. Well, that would be an example. My counsel can——

Ms. FLOWE. There are a number of different exceptions to coverage. Church plans, for example, are not covered by PBGC's insurance program. State government plans are not covered.

Mr. HANCOCK. Nonprofit organizations?

Ms. FLOWE. Certain professional service organization plans are not covered. There are a number of——

Mr. HANCOCK. OK. I am not going to ask you the reason that it is set up that way. I have got a pretty good idea.

Can you tell me how many plans were in effect at the time of 1974 when ERISA was formed in the first place? Or let's go at it another way. Can you tell me how many plans that your organization was looking at 10 years ago? Can you give me an idea there?

Mr. SLATE. I think that is something that we would have to——

Mr. HANCOCK. OK. Well, I would like to have this information in the record.

Mr. SLATE. We would be delighted to give it to you, sir.

Mr. HANCOCK. Can you tell me how many new plans are being formed? How many organizations now are agreeing to set up to take care of their employees a new qualified defined pension benefit plan, new ones?

Mr. SLATE. The answer is I don't have that at my fingertips.

Mr. HANCOCK. Can you tell me how many are being canceled on an annual basis because of the present way it is being administered?

Mr. SLATE. I would be delighted to submit that for the record.

[The information follows:]

RESPONSE TO REP. HANCOCK'S REQUEST THAT MR. SLATE PROVIDE INFORMATION ON THE NUMBER OF PLANS COVERED BY PBGC'S INSURANCE

Ten years ago about 110,000 single-employer plans were covered by PBGC's insurance program. Since then, the number has declined to about 65,000. The total number of participants has remained relatively stable—now slightly more than 32 million. The rate of fully funded plan terminations averaged slightly above 8,000 per year during the late 1980s, and dropped to under 6,000 per year in 1991 and 1992. New plan formations (based on premium filings) were below 8,000 per year in the mid-1980s and have declined at an increasing rate to about 2,000 per year in 1991 (the most recent completed premium filing year).

The number of multiemployer plans covered by PBGC has held at about 2,000 plans with almost 9 million participants over the last decade.

Mr. HANCOCK. Well, the record in previous testimony when GAO was here, approximately 10 percent was the figure that they gave us of organizations that are withdrawing from the defined benefit program and going into undefined prototype plans and what have you.

Now, as I understand the law, it was set up to guarantee the pension of primarily the private sector employees, to make sure that their companies properly funded it. It would appear that a result of the law has been a lot of people losing their benefit programs, defined benefit programs.

So another question that I have, is it not true, as Mr. Brewster said, that the properly funded plans are having to pay the premiums necessary to generate the reserves for your organization to guarantee the unfunded benefit plans, which makes it kind of an insurance operation?

Mr. SLATE. Let me address that and a couple things. Like you, I think we all share the concern about defined benefit plans. Whatever the figures are—and I am sorry I don't have them at my fingertips—it is true that the system is not—you know, that there are not that many people starting up plans relative to what has been before.

Mr. HANCOCK. Frankly, Mr. Slate, there are more people getting out than there are people getting in.

Mr. SLATE. That is right. That is right, there are more people getting out than are getting in. Now, part of that, sir, frankly, is a little bit of it may have to do with social demographics and so forth. But beyond that, we do share that concern, and I think that ultimately a viable PBGC would be very important to make people feel comfortable about going into the defined benefit system.

Mr. HANCOCK. Could you tell me, then, since you are taking over the operation of at least—I guess that would be your official title. Can you tell me how much—well, let me ask you, how many employees does the PBGC have? How many direct employees?

Mr. SLATE. Sure. Could I just add one thing to the other thing? And I am not trying to paint a picture any rosier than it is. But the fact is that the number of participants in the defined benefit

system has remained level. And I don't mean to in any way counter the concern that both you and I share about making sure that the DB system is as viable as possible.

In answer to your question on the employees, there are roughly 700 employees at the PBGC.

Mr. HANCOCK. 700 employees. And can you tell me what your budget is, what your overhead, your expense budget is?

Mr. SLATE. $33 million, I believe, sir.

Mr. HANCOCK. And those funds as of now are being generated by the premium on the existing pension program; is that correct?

Mr. SLATE. Sir, the budget thing is a long and complicated question, and I am not completely aware of it. I am not completely versed on it yet.

Mr. HANCOCK. I understand.

Mr. SLATE. But when you add all the benefits that are paid out and the services that we supply to plan participants as distinguished from our own typical Government budget—travel, administrative costs, and so forth—it comes to over $1 billion in terms of our——

Mr. HANCOCK. Comes to how much?

Mr. SLATE. Over $1 billion. The large part of it is payouts to participants. In other words, we are paying——

Mr. HANCOCK. No, I am not talking about the benefits you pay out. I am talking about strictly the administrative costs.

Mr. SLATE. OK. Well, you could look at it as somewhat of a—depending on how you define it, it could be as much as $100 million, from $33 to $100 million on how you define it, because some of the administrative costs—it could be defined as much as $100 million.

Mr. HANCOCK. Mr. Slate, pardon me for saying this—and I recognize that you have just recently taken over things.

Mr. SLATE. Right.

Mr. HANCOCK. But I would suggest that, in fact, this is the second time that I have had this type of situation, where I would suggest that when you come to testify to this committee, or to any other committee, that you be a little more familiar with how many people you are supervising——

Mr. SLATE. 700 people, sir.

Mr. HANCOCK [continuing]. And what your overhead is and how that is working out, because those are some of the questions that, as a businessman, I fully intend to ask every department head every time I get the opportunity, if he knows and is familiar with where he is spending the taxpayers' money.

Mr. SLATE. Premiums account for a large part of it, and the other part is earnings on the assets that we take when we take over when a plan is terminated and it is made subject to PBGC jurisdiction. Those assets are invested, and there are earnings on those investments. So our source of income comes from both the premiums and the investment of the assets.

Mr. HANCOCK. Well, frankly, what my concern is, number one, I want to make sure that people that have trusted—you know, I don't think there is anything that could be much worse than somebody who spent 30 years with a company and then all of a sudden finds out that due to mismanagement, maybe, of the funds that they had put in or they just didn't do it, that they didn't qualify.

We got into the situation, as you know, out in California with Executive Life. A lot of people really got burned when that insurance company went out of a business as a result of some other situations. That is tough because those people can't go out and start over on a career.

But I also think that if, in fact, we are going to do this, there are so many properly funded plans that the logical thing for them to do is to discontinue those plans, pay out the benefits, and go with a nondefined benefit plan. And that is what I understand a lot of employers, smaller employers especially, are being advised to do because of the overhead costs, if nothing else, of just completing this 5500. I mean, that thing is an expensive form to fill out if you have got much of an operation going. And also you are subject to some laws that could be serious penalties where you didn't even intend to violate the law and be hit with a $100-a-day fine or plus.

Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Hancock.

Now the Chair wants to ask some questions just to establish for the record some things I think that are factual, and then we will yield to other members if you have questions. Let me walk you through some of these questions, and you may give me a yes or no. You don't have to make a speech or an explanation or equivocation. Just try to answer the question if you can. These questions probably would be directed more to you, Mr. Slate, than to the others, but if any one of you has something you want to add to it, go ahead.

Let me try to establish something factually first. Isn't it a fact that the PBGC is currently operating on a deficit? Mr. Slate?

Mr. SLATE. Yes. As I have indicated in my testimony, it is.

Chairman PICKLE. It is $2.7 billion now. It is up $200 million from last year. Within the next 3 or 4 years, it will go to $3 or $4 billion. Essentially, is that your opinion?

Mr. SLATE. Those projects are hard to make, sir, because we have a small number of claims of large money. But as I indicate in my testimony, every indication is that it is likely to grow.

Chairman PICKLE. All right. Well, it is not likely. We——

Mr. SLATE. Very likely.

Chairman PICKLE. Very likely. That is a little better, Mr. Slate. Well, isn't it a fact that this deficit has grown despite significant increases in the PBGC premium rates and income?

Mr. SLATE. Yes, and that is one of the things the task force is looking at.

Chairman PICKLE. In 1981, I understand we had about $81 million in income from premiums. Last year it was $876 million. So in spite of the fact that our income had grown greatly, our problem is increasing even faster than income.

All right. Isn't it a fact that there has been a decrease in the level of funding of sponsors of underfunded plans in recent years?

Mr. SLATE. Yes, and we are looking at the why's of that.

Chairman PICKLE. We have increased this last year by at least $10 billion. It may be another $10 billion next year. So we must recognize that as a fact.

Now, isn't it a fact that PBGC insurance does not cover all the benefit increases that have been promised to the workers by the employers' pension plans?

Mr. SLATE. Over time, yes.

Chairman PICKLE. I don't know what you mean by "over time."

Mr. SLATE. Well, as I indicated, we can pay the bills that are due and owing now, and we will be able to pay them. But if you are looking, as you say, at the long-range promises, we have a concern, absolutely.

Chairman PICKLE. Well, let me be a little more specific on my viewpoint. The General Accounting Office in our last hearing testified that a lot of workers were losing their benefits, even though they were paying their pensions. Now, we had five witnesses testify that they individually didn't know, didn't get notice, didn't understand. And when they retired, their pension funds were cut in half at least, if not more.

Now, if that is happening to five industries, representatives of five different industries, then that is a common practice, and we just must accept that all employees are not protected under the present plan. Is that not correct?

Mr. SLATE. Yes. I am sorry. I didn't understand, sir. The guarantees don't cover everything in many cases.

Chairman PICKLE. Now, isn't it a fact that some employers—I am talking about the plan—continue to amend their plans to increase their pension promises even though they have not funded their past promises? Is that correct?

Mr. SLATE. Yes, it is, and that is one of our concerns.

Chairman PICKLE. Well, the General Accounting Office—I want to add this—reported to the subcommittee that in 1990–91, eight of the largest unfunded plans increased their unfunded liability by $5 billion, of which $2 billion was attributable to benefit increases. One automobile company had given more than $500 million, and another, $1.5 billion, even though their funds were unfunded. Is that not correct?

Mr. SLATE. Yes, and I think we said in our testimony that almost half the increase is because of that.

Chairman PICKLE. All right. Now, I don't want to sound alarming, but I want to ask you this question. Isn't it a fact that employers with underfunded plans will continue to go bankrupt from time to time in the future?

Mr. SLATE. If the economic trends continue, it certainly is a fact.

Chairman PICKLE. All right. Well, then, isn't it a fact that the administration would ask Congress for additional funding if at some future date PBGC lacked the resources to meet its financial obligation?

Mr. SLATE. It is too early to predict whether we would have to ask. One of the things we have talked about is recommending steps that will take care of that problem while it is still manageable.

Chairman PICKLE. Both you know and I know that that is not only likely, it is very, very likely. It has happened in the S&L's. It is going to happen in pension funds, probably more quickly than in the S&L's. So we must admit that to ourselves and then go forward to find an answer. And I think it ought to be found, and ought to be found soon.

Now, clearly, it seems to me that the failure of a minority of the employers to fund their pension plans put workers and retirees, taxpayers, and those companies that sponsor well-funded plans at risk. That was the point Mr. Hancock was making, that the companies that fund their plans are really financing the big companies that are not funding their plans.

Now, what public purpose, Mr. Slate or Mr. Lebowitz or Mr. Hardock, what public purpose is served by allowing sponsors to operate significantly unfunded pension plans?

Mr. SLATE. Sir, anything that stands in the way of benefit protection is a matter of concern. The funding rules allow flexibility in funding certain types of defined benefit plans because of the need to balance the competing situations. But the more chronic the underfunding, the greater the concern, and particularly in the context of a troubled company.

Chairman PICKLE. Do any of you want to give me a good public purpose explanation, what is served by allowing these unfunded plans to continue to be unfunded?

I would be just like you if I were sitting out there. I don't think I could come up with a good answer. There is no good public purpose; therefore, we have got to correct the system. And we had better set about to do it.

Let me say this to the Department of Labor. Will you, Mr. Lebowitz, or Mr. Slate, or any one of the three of you, recommend grandfathering in, in September, the new unfunded promises made by the Big 3 in August?

Mr. SLATE. I am certainly not prepared to make that recommendation. It is very premature.

Chairman PICKLE. Would any of you recommend it? What is going to happen? What is magic by the September 15th date? You want to postpone this until September. Why?

Mr. SLATE. I think, sir, as I said, we are a new administration. We are taking a fresh, comprehensive look at the situation. And it is my assessment that to do this thing and to develop a solution for the long term, an effective solution while it is still manageable, that that would be an appropriate time frame.

Chairman PICKLE. Well, let me venture an opinion without trying to be curt, but I asked a question and your answer is general. I think that there is not anything magic about the September 15th date. I just think that is a date after the Big 3 have negotiated more pension benefits. If they do negotiate pension benefits, are you then going to grandfather them in in your recommendation?

Mr. SLATE. I would not rule that in or out. The effective date—and, again, this is speculation. The effective date of legislation is always something that you have to look at.

Chairman PICKLE. Any of you others have any different opinion on that?

Mr. HARDOCK. Mr. Pickle, I think the September date, as Mr. Slate indicated, is his preliminary thought. Secretary Bentsen is very committed to moving this process forward and having an administration position on it, and that will take some time. And it is time to get good answers and right answers. I don't believe there has been any decision on a particular date.

Chairman PICKLE. I am glad Secretary Bentsen is there, and I believe Secretary Bentsen's and Secretary Reich's intent is very strong, and I think they want to see something done. But I think if we wait until September, after the Big 3 have negotiated, we will have made a promise to accept $2 or $4 billion worth of benefits. The problem then is exacerbated. And it seems to me if we are going to do that, we ought to say right now—if we do let them negotiate, we are going to make the effective date as of today. If you don't, then we are saying to one group we are going to change the law, but you don't have to abide by it; we are going to change it for all other employers in the country, but not you; we are going to let you get by.

Anybody want to comment on that statement?

[No response.]

Chairman PICKLE. Well, I will just say to you that that is the concern we have, and we are very mindful that this is a problem for some of these companies, particularly the airlines, the automobile, the tire company. We understand that. But we also understand and believe—I do, at least—that something ought to be done and we ought to be making it now. And if we want until after September, the chance of getting this bill means that that is going to be held up by other committees, even if we could reach agreement, and there would be a hold on it, and you will see 1994 and 1995 come and nothing being done. Now, that ought not be allowed, and I think we just must bite this bullet and try to do something about it.

Well, let me go ahead with some of these questions. This is primarily for you, Mr. Lebowitz, the Department of Labor. When and what information must be provided to participants if plan funding level falls below the 100 percent, 90 percent, 80 percent, or 70 percent? And you used the figure of 60 percent. Do you send out notices only when the plans are underfunded by 60 percent or 70 percent?

Mr. LEBOWITZ. There are different mechanisms for providing information to participants depending on the circumstance. In the 5500 form, in the annual report, there is an attachment to the annual report called the Schedule B. It contains a lot of actuarial information. On that schedule, the value of the benefits that have been accrued under the plan is listed, as is the assets that are in the plan to support those benefits.

Under the statute, if the funded percentage is 70 percent or below, then that has to be specifically described. In addition, there is something called a summary annual report which is provided to participants, which summarizes that which is in the annual report. This underfunding, if it goes below the 70 percent mark, has to be described in the SAR.

The 5500 also has to have certified financial statements. The accountant who certifies the plan's financial statement will note on the financial statement not only what the assets are but what the accumulated benefit liabilities are.

It is not an easy process, Mr. Chairman, for a participant to wade through all of this and get a very clear picture. The information is there, but it is somewhat difficult. And if I might say, it is even more difficult for the participant to be able to translate that

information into a specific understanding of how it affects him or her. But the information is there.

Mr. KLECZKA. Mr. Chairman, would you yield on that point?

Chairman PICKLE. Are you finished, Mr. Lebowitz?

Mr. LEBOWITZ. Yes, sir.

Chairman PICKLE. Yes, Mr. Kleczka.

Mr. KLECZKA. Mr. Chairman, let me stay on the same point, that being the summary that is shared with the plan participants. How often is that summary shared with them? Is it annually?

Mr. LEBOWITZ. Annually.

Mr. KLECZKA. And how long after the actual 5500 has been filed do they get a copy?

Mr. LEBOWITZ. It is 2 months after the annual report is due.

Mr. KLECZKA. OK. So assuming, what, a December 31 due date—are they all standard?

Mr. LEBOWITZ. No, but they do tend to be—most plans tend to be calendar year plans.

Mr. KLECZKA. OK. So by February, the bulk of the plans do issue a summary to the participants?

Mr. LEBOWITZ. No. Under the law, the annual report itself, the 5500, is not due until 7 months after the end of the plan year.

Mr. KLECZKA. OK. We are told that some employers submit that 5500 even later than that. We are talking 2 years.

Mr. LEBOWITZ. Well, there can be extensions to the 7-month period of 2½ months, and then there is 2 months after that that is permitted under the law before the summary annual reports are—

Mr. KLECZKA. So a participant could possibly get the summary, which is not legible and—which is legible but not readable, for a 1991 plan status in 1993, possibly. And at that point, if the plan is in serious problems, the employee can take that summary and chuck it out because they could be headed for the PBGC, or you could be already administering it.

Now, with this task force that is going on, are you folks going to look at the actual summary and possibly simplify it for the employee? You mentioned in response to the chairman that it is not easy for the participant to sift through this. Well, I think it is our job to make it easy, maybe use plain English, because once you get the pension and ERISA and things of that nature, this is complicated business, you know, even for those of us on the committee here. And for a person who has never been exposed to it, it has got to be horrendous.

Is there a way to send this person a more timely summary of their plan, legible—not legible but readable, easy to understand, plain simple English?

Mr. LEBOWITZ. We in the Department are looking at that issue to see if there are ways that we simplify things. The timing——

Mr. KLECZKA. On a rating system of 1 to 10, A to F, you know, so a person like myself can understand whether or not the plan I am in has any problems.

Mr. LEBOWITZ. Part of the problem is that the plans themselves are very complicated. The law is very complicated. The plan is very complicated. And it is very difficult, try as many companies do to explain things in as simple a fashion as they can, to keep it simple. And, of course——

Mr. KLECZKA. OK, but if a plan is seriously underfunded, I think that would be kind of easy to ascertain.

Mr. LEBOWITZ. That is right, and the——

Mr. KLECZKA. And at that point we can easily tell the employee that your plan is in serious trouble, either it is unfunded to the point of 60 percent, 70 percent. At least that person knows where they stand, especially as their retirement date comes nearer, or if they just left the bargaining table and they walked away the beneficiaries of some gigantic increases in the pension plan. You know, at least at that point, annually they will know what we got is written in sand, or I am 2 years away from retirement, things aren't looking good, I might not be able to count on the prescribed benefit, I might get the maximum provided by PBGC.

But there has got to be some way to simplify that and hopefully maintain the accuracy.

Mr. LEBOWITZ. I think those are fair points, and those are things that we have been looking at and we are going to continue to look at to see if there are ways that we can do.

Mr. KLECZKA. Well, underscore the "plain English" type of requirement because right now, even to myself, when I was looking over my wife's pension plan, which is TIAA–CREF, good luck, you know? And I am an expert on PBGC. How is that?

Mr. LEBOWITZ. We have trouble understanding that one ourselves.

Mr. KLECZKA. Good. Thank you.

Chairman PICKLE. Well, let me comment on that and ask this question. Is current law about informing participants satisfactory?

Mr. LEBOWITZ. I personally think—I am speaking for myself here—that there are issues that should be looked at very seriously. I think the timing of the delivery of some of this information may have been appropriate 20 years ago when ERISA was being enacted, and the state of the technology that was available to plan participants was, by comparison with current day, rather primitive. I think that those issues need to be looked at. The content of the disclosures should be reviewed to see if they are meaningful and understandable.

I think personally that there is a lot that can be the subject of a very serious review.

Chairman PICKLE. Well, Mr. Lebowitz, I think we have to all admit that current law does not give the participant any real information about the status of his pension plan. The witnesses we had recently before this committee had no idea, really, of the status of their pension plans. No way for them to know.

Do you think that it is possible for a worker today to really know fully whether his pension plan is funded or not?

Mr. LEBOWITZ. Well, I think it is possible. I don't think it is easy. But I do think it is possible.

Chairman PICKLE. Well, you are saying that is very unlikely—that is your phrase—that he would know really what the status was. You get the information on the 5500. If there is an annual report, and I want to make some reference to it, but who is going to read these annual reports that looks about the size of the President's budget of some 2,000 pages or whatever it is. And the information on the 5500 may not come in until a year or 2 years later.

So that participant is not going to know. He has no real way at the present time to know.

Your current regulations require that a statement be made on the summary annual report to the specific question about the value of the pension plan. Let me give you an example. On General Motors, the value of the plan assets was minus $6 billion at the end of 1991, compared to a minus $2.4 billion at the end of 1990.

Now, did General Motors send this statement to its participants?

Mr. LEBOWITZ. I don't have the General Motors SAR in front of me.

Chairman PICKLE. Does anybody think General Motors sent that notice out, that information out?

Well, your silence indicates that no, of course they didn't. It is very difficult for the participants to know, and we have got to correct that and I think your statement is that we ought to do something about it.

Let me ask Treasury, are there companies which sponsor underfunded pension plans for hourly workers while at the same time the companies are operating and fully funding their pension plans for management employees?

Mr. Slate or one of you—maybe it was you—said there was a difference in defining it. But the real question is: Are they funding the good programs for salaried and high executives and not funding the hourly program? Is that correct?

Mr. HARDOCK. Yes.

Chairman PICKLE. Well, that is a good answer. I will go on.

It seems to me that something has got to be done when we know these are facts that we are facing, and we all agree something should be done. And we can take comfort, as some of you have said this morning, that we have got no cash flow problem now. We can pay for any benefits that might be asked of us, and that is true, perhaps, for 2, 3, 4 years under normal conditions. But we know if the trend continues, as we have established, we know that in a short period of time we may face enormous problems in this field. So timing is the question for us, and the question is: Should we wait until September when these other plans have been negotiated, or do we try to do something about it now? I am one to think that we ought to go ahead and try to do it now.

The Chair will recognize Mr. Brewster.

Mr. BREWSTER. Thank you, Mr. Chairman.

Sitting here thinking about this a little longer, we talked about a moment ago that you are operating currently at a $2.7 billion deficit. Is that correct?

Mr. SLATE. That is our long-term deficit. One thing I do want to make clear, sir, is that the cash flow problem is quite sound, and it will be sound as far as the eye can see, even under the most pessimistic situation. There is a long-term deficit of $2.7 billion, and as I indicated, it is very, very likely to grow.

Mr. BREWSTER. OK. So you currently are taking in more money than you are paying out?

Mr. SLATE. Yes.

Mr. BREWSTER. Does that go in a trust, or what is the status of that money?

Mr. SLATE. That money, except for the money that is used to pay salaries and so forth, is put in a trust, and it is invested.

Mr. BREWSTER. How much is in there currently?

Mr. SLATE. Pardon me?

Mr. BREWSTER. How much is in there currently?

Mr. SLATE. I think it is somewhere between $6 and $7 billion, I believe.

Mr. BREWSTER. Between $6 and $7 billion?

Mr. SLATE. Yes.

Mr. BREWSTER. But your long-term——

Mr. SLATE. And the long-term liabilities would be close to 9, so that would be—say it is 6.3 versus 9.0 or something like that.

Mr. BREWSTER. OK. Well, I keep reading where there may be as much as a $60 billion liability there.

Mr. SLATE. Let me explain that. Actually, for all plans it is $50 billion, and for single-employer plans, which has kind of been the focus of our efforts, it is $40 billion.

What that is is the amount of—in adding up all the plans in the country, all the plans under our coverage, the difference between the assets that the plans have and the benefit liabilities that those plans may owe. Now, the majority of those plans are with companies that are fairly strong and for which the likelihood of having to terminate and hit the Government with a debt is remote.

However, as Mr. Pickle pointed out, there is a healthy minority of companies in a few industries where there is underfunding and where there certainly would be circumstances where they may terminate their plans on an underfunded basis.

Mr. BREWSTER. OK. You mentioned that you about $6 billion in investment funds now, between $6 and $7 billion. How much is that growing a year at the moment?

Mr. SLATE. Pardon me?

Mr. BREWSTER. You say that you are operating on a good cash flow basis. You are adding to the money in trust, more or less. How much are you increasing that each year?

Mr. SLATE. OK. The figures for last year, sir—and this is one where, you know, I really have to learn more, and I will be glad to give it to you. But as I understood the figures for last year, it was about 11 percent earnings. So if you did that, it would be several hundred million. But I think I am going to have to give you that.

Mr. BREWSTER. In total numbers, counting the investment side of it and what people were paying into it, it increased several hundred million last year?

Mr. SLATE. Well, there was $900 million in premiums and several hundred million in investment returns. So it increased by—I think it was probably $1.3 or $1.4 billion. But, again, I am just give you a range here.

Mr. BREWSTER. There was $900 million more in premiums than there was paid out?

Mr. SLATE. No. There was—I mean—let me see if I can get a figure here.

Mr. BREWSTER. What I am curious about, is there a net increase or decrease when you add in the investment funds, the premiums, against what was paid out?

Mr. SLATE. OK. The benefit payments last year were $730 million. When you take the premiums and the other receipts and so forth, we made close to $1.4 billion.

Mr. BREWSTER. So, in essence, it increased about $400 million that you have in trust to eventually pay off whatever is here.

Mr. SLATE. Yes.

Mr. BREWSTER. One more thing. Is there any reason why this committee should not pursue the chairman's bill that says unless you are 90 percent funded you can't give additional benefits?

Mr. SLATE. OK. It is premature for us to make any statement on that.

Mr. BREWSTER. I am not asking you if you support it or don't support it. I am saying do you know of a reason why we should not do that?

Mr. SLATE. This is a very complex question, sir, and I am not in a position—I am just not ready to take a—I am not ready nor is the administration ready to take a position on that provision.

Mr. BREWSTER. I wish I could get away with that answer with my constituents.

Mr. SLATE. It is a real concern.

Mr. BREWSTER. Thank you.

Chairman PICKLE. Thank you, Mr. Brewster.

Mr. Herger, do you have any additional questions?

Mr. HERGER. A question and a comment. Mr. Slate, I want to make sure I understand the general direction that you are going in. You just mentioned a couple minutes ago, if I understood you correctly, that there is more money coming in than what we are paying out, and I would get the implication from that that all is well. And I hope that is not the implication I was receiving from that. And to the question of whether or not we feel we should be making any changes, obviously the administration is new and you don't know exactly, but I would think just from what we have heard here in our hearing today that it would be incredibly clear to virtually anyone that we do need some major changes.

A deficit of $2.7 billion today, that is more than double what it was just a few years ago. We have those that are paying into pension funds in companies for the most part who are in trouble that don't have any idea they are in trouble. And even when they do receive a statement indicating that, it is a statement that they can't read or understand.

We have had witnesses before this committee on this very issue just a few weeks ago who were receiving only 50 percent of what they thought they would be receiving.

Again, just a closing question. Do you see a major problem here, a major problem that you feel committed to changing?

Mr. SLATE. Sir, if the administration did not have such a concern for benefit protection and if all were well, we wouldn't have set up the task force, we wouldn't be moving quickly, and we wouldn't be here this morning.

We share your concern. I essentially have—we share your concern. We think that there is a long-term problem, and my message is essentially twofold: number one, that benefit payments are safe and there should not be concern about that; but, secondly, we need

to develop a solution for the long term while the situation is still manageable. And we look forward to working with you on that.

Mr. HERGER. And you see this as a top priority that you are going to be working on and coming up with a plan in the near future?

Mr. SLATE. I think as Director of the PBGC I am obligated to look at that very carefully and to move forward to implement whatever Secretary Reich finally decides on.

Mr. HERGER. I appreciate that. One last question. Do you have a time frame of approximately when you would see that taking place, this recommendation?

Mr. SLATE. Well, as I indicated, if the decision were to—and, again, this is my personal assessment. If a decision were to be made to go ahead with legislation, I would think that the aim date would be September.

Mr. HERGER. Very good. Thank you very much.

Chairman PICKLE. Wouldn't it be more accurate to say it would be September 1994? The truth of the matter is if you don't get some action soon, it will be held up this fall, and you won't get action probably until September 1994, just before an election, and you might kiss it goodbye if that was the case.

I don't want to appear to be facetious, but I am trying to be practical about this matter.

Now, Mr. Lebowitz, you made a good statement to us. You submitted to us some documents that we had asked for. But nothing in the documents that you submitted, as an example of information for the participants, mentioned the PBGC's guarantee, the plan's level of funding, or the fact that when a plan is terminated the workers may not get their full pension benefits. I don't find that a clear statement of facts as the situation exists now.

Now, you did mention that under Section 303 of ERISA, it requires an applicant for a waiver to provide evidence that the applicant or the company has provided participants with notice.

Now, that much is required by the law. But isn't it more accurate to say that this section only requires notice to the union representatives and that there is no requirement that retirees be notified at all? Is that a fact?

Mr. LEBOWITZ. I think you are right, Mr. Chairman.

Chairman PICKLE. Well, then, I would agree with you, Mr. Lebowitz. Isn't it a fact that in almost all cases the union does not represent retirees and, therefore, does not represent all participants?

Mr. LEBOWITZ. I don't know that I can really respond to that. There are a variety of different situations, I am sure, and it is the IRS that has the responsibility for making determinations on waivers.

Chairman PICKLE. Well, the fact of the matter is that while the unions are very important negotiators in this process, the same is also true that they do not represent all the employees, and that usually the only people that get notice is the union people, and they may or may not tell their employees, because they are interested in jobs more than they are interested in the solvency of the plans.

That is a rather strong personal statement, but I think that is what most people would probably say.

While the waivers are important and they are going down—and you have worked on that, you and Mr. Slate have worked on this particularly in the recent years, I think we have got to be very—we have got to recognize that even though there are waivers, notice still isn't given. The participant really doesn't know. And I think there is general agreement here that we can make an improvement in this field, and I think that we must do it.

Now, I think we have established the fact today that we have got a problem, that you admit it. I think we have established the fact that corrections should be made. You admit it. We have established the fact that many of the larger companies, particularly in the automobile and airline and other industries, are underfunded—two of the companies are underfunded by some $16 billion—and that that should be corrected.

Now, we all know that those are facts. The question now: When can we do it? And I would say that each of you is charged with the responsibility of giving this committee the best advice and recommendation you can. As you work on these plans or these recommendations, we will expect you to keep us informed regularly because the solvency of the American worker, the peace of mind of the American worker is at stake in this question, and we must not be indulged in generalities. We know some loopholes have existed.

We changed the 1987 law. We allowed some loopholes to exist, and they are still there. While we did correct a lot of the unfunded plans and strengthened them, we still haven't corrected the problem at all. So I am saying to you that we have got to get to work on this, and I hope that you will give us speedy action on it.

We have got another panel, so I am going to go to the next panel if no others have any question. Mr. Kleczka, do you have a question now?

Mr. KLECZKA. Again, as a followup, Mr. Chairman, to one of the points that you raised to Mr. Lebowitz, currently if a plan is given a funding waiver, are the participants notified of that action?

Mr. LEBOWITZ. They are not specifically notified of that, no. I believe that there is information——

Mr. KLECZKA. OK. They are not specifically. What do you mean by that?

Mr. LEBOWITZ. I believe that there is information on the Schedule B that I talked about before that——

Mr. KLECZKA. OK, but that is part of the 5500 form?

Mr. LEBOWITZ. Right.

Mr. KLECZKA. Which is not shared with the participants?

Mr. LEBOWITZ. It is available to participants. It is not provided directly to them.

Mr. KLECZKA. Well, swell.

Chairman PICKLE. It is available, but you don't——

Mr. KLECZKA. No one knows where it is, and no one knows how to find it. And if you find it, it is not accurate or it is not timely, anyway, because it could be 2 years late.

Is there any objection to telling people that their plan has received a funding waiver, Mr. Lebowitz or Mr. Slate? Do you have any problem informing the participants?

Mr. SLATE. Let me first of all underline, as I said in my testimony. What this committee and other committees did in 1987 is forged the way to make the waiver situation, frankly, much less central to a discussion on this area. But——

Mr. KLECZKA. But it still occurs. Waivers are still granted, are they not?

Mr. SLATE. Well, sure. They are, but they are not applied for nor granted in anything like that numbers that they were, thanks to the law that you put in.

Mr. KLECZKA. Fine.

Mr. SLATE. Now, having said that, it is a complicated area because you have tax disclosure rules, and I think that the law is such that the participants are not to receive that information at the time a waiver is granted. I——

Mr. KLECZKA. Well, could your task force look at that and possibly make a recommendation to change the law?

Mr. SLATE. The answer is I think that is——

Mr. KLECZKA. We are talking about an issue here that is the participants' right to know this information. We are not divulging the gross income or any other specific tax information, just the simple fact that, folks, there is a red light going on here, your fund might be in problems, and your company has just received a waiver. Very simple.

Mr. SLATE. OK. I can't speak for the IRS. I think that is something that folks ought to look at, and I think you have done a good job on this.

Mr. KLECZKA. OK. Is the IRS participating in the task force with you?

Mr. SLATE. The Treasury Department makes policy, sir, so they have been the major representative. But we have had technical people from the IRS serve as technical resources.

Mr. KLECZKA. Let's look specifically, when you convene your task force, at that particular item.

Mr. SLATE. Sure.

Mr. KLECZKA. Again, using the basis that I think it is the public's right to know, or specifically the participants' right to know.

Thank you. Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Kleczka, and thank all the members for your questions.

I am going to move on to the next panel now, and I thank each one of you for your participation.

Now the Chair is going to call the next panel: Mr. Joseph Delfico, representing the General Accounting Office, and Mr. James Blum, representing the Congressional Budget Office. If you will, please take your seat at the witness table.

We will ask Mr. Joseph Delfico, Director of the Income Security Office of the General Accounting Office, to present his statement first, and then followed by Mr. James Blum, the Deputy Director of the Congressional Budget Office.

Mr. Delfico.

STATEMENT OF JOSEPH F. DELFICO, DIRECTOR, INCOME SECURITY ISSUES, HUMAN RESOURCES DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. DELFICO. Thank you, Mr. Chairman. With me today are Michael Packard and Donald Snyder, who helped prepare this testimony.

Thank you for inviting me today to testify on underfunded pension plans. I have a 5-minute statement here I would like to read to you and submit the full statement for the record.

Chairman PICKLE. Without objection, we will include it in the record.

Mr. DELFICO. Funding requirements for defined benefit pension plans were last improved by the Pension Protection Act of 1987. Despite these improvements, pension funding has not improved for many plans. The percentage of plans insured by PBGC that pay a variable premium because they are underfunded increased from about 17 percent in 1989 to about 23 percent in 1991. Over this same period, PBGC estimates the total underfunding in its insured pension plans increased from $30 billion to $51 billion.

One feature of the Pension Protection Act was a requirement that sponsors of many underfunded plans make an additional contribution to the plan. We looked at a random sample of 93 plans from the 5,300 plans subject to the additional contribution requirement to determine how many were actually making the additional contributions. The preliminary results of our study show that few sponsors are making additional contributions.

Our results to date show that 33 plans, more than a third of the plans in our sample, were not underfunded on a current liability basis, the basis that determines whether the additional contribution should be made. Of the remaining 60 plans in our sample: sponsors of only one-third of the plans were making additional contributions under the 1987 provision; almost half the plans did not have to make additional contributions because allowable credits for certain amortization payments already being made offset their additional contribution obligations; almost 20 percent of the plans did not determine if they had an addition contribution obligation.

We calculated the additional contribution obligation for the 11 plans that did not make the calculations themselves. Our analysis shows that 6 of the 11 plans should have made additional contributions. The large portion of underfunded plans in our sample that did not make this calculation is troubling and suggests there may be enforcement problems here. We have not yet discussed these findings with the Internal Revenue Service, however, but we will soon do that.

We found that the offsetting credits seriously eroded the effectiveness of the additional contribution provision. After including estimated additional contribution obligations for the 11 plans not making the calculations themselves, we found that more than half of the 60 underfunded plans in our sample were able to avoid making additional contributions because of the offsetting credits. In addition, the offsetting credits reduced the additional contribution payments for 15 plans that made, or would have made, such payments.

Our preliminary analysis indicates that the current funding rules for underfunded plans have not produced as dramatic an increase in the contributions as the framers of the rules might have anticipated. These rules, however, allow sponsors of most underfunded plans to avoid making additional contributions. If Congress wants to further improve the funding levels in underfunded plans, then it may need to consider legislating additional improvements to the funding rules.

Two bills have been introduced recently that would improve funding in most plans with unfunded currently liabilities. These bills would require sponsors of such underfunded plans to make minimum contributions equal to the highest of the contributions required under three different funding rules.

These rules are complicated but may be briefly described as: the ERISA rule, which is the current contribution requirement without the additional contribution obligation; the deficit reduction rule, which would modify the current additional contribution rule and eliminate the offsetting credits; and the cash flow rule, which would be a new rule having contributions equal to plan expenditures plus other charges.

Our preliminary analysis of the effects of these bills indicates that the total contributions would increase for approximately 75 percent of the plans in our sample. However, the contributions for more than 10 percent of these plans would decline from the current levels.

Figure 2 in our testimony and the chart here on the right shows the level of contributions required for our sample of 60 plans by current law and by the various components of the proposed legislation using the ERISA rule as the base. And that is the darker bar on the right. The current law increased total funding in our sample of plans by 8 percent. The proposed rules would have a much larger effect, as you can see by the higher bars on the righthand side of the chart.

The deficit reduction rule could be more effective than current law in accelerating plan funding improvements. This rule would almost double the total contributions for these plans. Moreover, the cash flow rule would more than quadruple contributions. The proposal that plans make contributions equal to the highest of the three funding rules would require contributions of more than four times the total ERISA contribution.

While the proposed legislation would help improve funding in many underfunded plans by requiring additional contributions, it is important to note that the new rules could substantially increase required contributions for many plan sponsors. This would appear especially true for sponsors who would be subject to the new cash flow rule.

Mr. Chairman, this concludes my brief statement. I will be happy to answer any questions you or other members may have.

[The prepared statement and attachment follow:]

STATEMENT OF JOSEPH F. DELFICO, DIRECTOR
INCOME SECURITY ISSUES, HUMAN RESOURCES DIVISION
U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me here today to discuss our work on defined benefit pension plan funding issues. Because this work is still in progress, I wish to stress that our results are preliminary. They indicate that the current funding rules need improvement and that proposed legislation, while having shortcomings, would substantially increase contributions for many plans.

The majority of pension plans insured by the Pension Benefit Guaranty Corporation (PBGC) are well-funded. However, a significant minority of plans are underfunded and the level of underfunding in these plans is growing. This increasing underfunding raises concerns for all involved, that is:

-- PBGC faces an increase in its exposure to the risk of terminating underfunded plans.

-- Sponsors of financially sound plans may see their PBGC premiums increase to cover PBGC's growing losses.

-- Plan participants may lose some of their benefits should their underfunded plan terminate.

-- Taxpayers may have to pay should PBGC exhaust the assets it has for paying its obligations.

Improving the funding in underfunded plans should benefit each of these groups.

HISTORY OF PENSION PLAN FUNDING REGULATIONS

Before the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), only minimal funding rules existed. Many participants lost promised benefits when their underfunded plan terminated. Among other provisions, ERISA established firm minimum funding rules and created the PBGC to insure the pensions of participants in defined benefit plans. The improved funding rules worked as intended for many plans, but by the mid-1980s what became apparent was that the funding in some plans needed improvement.

The Pension Protection Act (PPA), a part of the Omnibus Budget Reconciliation Act of 1987 (OBRA 87), introduced certain reforms to ERISA aimed at bolstering funding levels in underfunded plans. PPA instituted an additional premium for underfunded plans (the variable rate premium); modified the contribution waiver process; introduced quarterly contributions and required notification to PBGC of missed contributions; reduced some amortization periods; revised guidelines for using actuarial assumptions; and, established an additional contribution funding requirement for underfunded plans.

ARE THE CURRENT RULES IMPROVING PLAN FUNDING?

In the aggregate, available evidence suggests plan funding for underfunded plans is not improving. The percentage of plans insured by PBGC that pay a variable premium because they are underfunded increased from about 17 percent in 1989 to about 23 percent in 1991. Over this same period, PBGC estimates the total underfunding in its insured plans increased from $30 billion to $51 billion. PBGC reports that the surplus of assets in the fully funded plans it insures dropped from $251 billion in 1990, to $183 billion in 1991. In part, this funding deterioration is caused by declining interest rates. The decline in the surplus of well-funded plans was also caused in part by PPA's funding limitation which precludes sponsors of very well-funded plans from making contributions to their plans.

GAO's ANALYSIS OF FUNDING
IN UNDERFUNDED PLANS

The PPA established an additional contribution requirement to reduce underfunding in underfunded plans, the Internal Revenue Code 412(l) provision. To test the effectiveness of the 412(l) provision, we are analyzing a randomly selected sample of 93 large underfunded plans that were paying PBGC's variable rate premium in 1990. Our results to date show that 33 plans, more than one-third of the plans in our sample, were not underfunded on a current liability basis, the basis that determines whether an additional contribution should be made.[1] The preliminary results of our study, based on the remaining 60 cases, show that (see fig. 1):

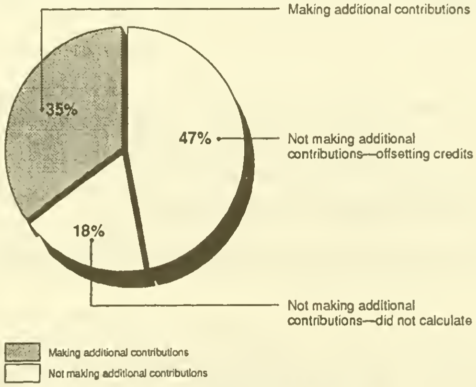
-- Sponsors of only one-third of the plans (21 plans) were making additional contributions under the 412(l) provision.

-- Almost half the plans (28 plans) did not have to make additional contributions because allowable credits for certain amortization payments already being made offset their additional contribution obligations.

-- Almost 20 percent of the plans (11 plans) did not determine if they had an additional contribution obligation.

We calculated the additional contribution obligation for the 11 plans that did not make the calculations themselves. Our analysis shows that 6 of the 11 plans should have made additional contributions. The large portion of underfunded plans in our sample that did not make this calculation is troubling and suggests there may be an enforcement problem. We have not yet discussed these findings with the Internal Revenue Service (IRS), however.

Figure 1: Few Underfunded Pension Plans Make Additional Contributions (1990)



Note: Based on a sample of 60 plans paying PBGC variable rate premium

[1]See the appendix for a description of our sample, a summary of the current 412(l) provisions, and a description of the proposed funding rule changes contained in S.105 and H.R.298.

We found that the offsetting credits seriously eroded the effectiveness of the additional contribution provision. After including estimated additional contribution obligations for the 11 plans not making the calculations themselves, we found that more than half the 60 underfunded plans in our sample (33 plans) were able to avoid making any additional contributions because of the offsetting credits. In addition, the offsetting credits reduced the additional contribution payments for 15 plans that made, or would have made, such payments.

We found that the effect of offsetting credits on additional contributions were concentrated in underfunded flat benefit plans.[2] Two-thirds of the flat benefit plans, compared with less than 40 percent of the salary and other plans, made no additional contribution because of the offsetting credits. One reason for this is the splitting of plan underfunding into old and new components and amortizing the new component over a shorter period of time.[3] This results in a smaller additional contribution, before taking the offsetting credits, than if the total plan underfunding were amortized over the shorter period now applying only to the new component. We found that flat benefit plans were more than twice as likely as salary and other plans to have at least 75 percent of their 1990 underfunding in the old liability category.

Our preliminary analysis indicates that the current funding rules for underfunded plans have not produced as dramatic an increase in contributions as the framers of the rules might have anticipated. These rules allow sponsors of most underfunded plans to avoid making additional contributions. If Congress wants to further improve the funding levels in underfunded plans, then it may need to consider legislating additional improvements to the funding rules.

S.105 AND H.R.298

Two bills (S.105 and H.R.298) have been introduced recently that would improve funding in most plans with unfunded current liabilities. These bills would require sponsors of such underfunded plans to make minimum contributions equal to the highest of the contributions required under three different funding rules.

These rules are complicated but may be briefly described as (1) the ERISA Rule, which is the current contribution requirement without the additional contribution obligation, (2) the Deficit Reduction Rule, which would modify the current additional contribution rule and eliminate the offsetting credits, and (3) the Cash Flow Rule, which would be a new rule having contributions equal to plan expenditures plus other charges.

Our preliminary analysis of the effects of these bills indicates that total contributions would increase for approximately

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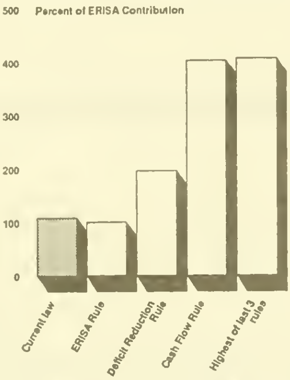
[2]"Flat benefit plans" is used to describe defined benefit plans calculating monthly benefits by multiplying years of service in the plan by a fixed dollar amount. Most flat benefit plans are negotiated union plans. The other major type of defined benefit plan is salary-based and calculates monthly benefits by multiplying years of service in the plan by some measure of earnings. Flat benefit plans make up 60 percent of our sample of 60 underfunded plans.

[3]Old underfunding is the unamortized portion of the underfunding that existed at the beginning of the 1988 plan year. New underfunding is the difference between old underfunding and the total underfunding in the plan at the beginning of the current year.

75 percent of the plans in our sample of 60. However, the contributions for more than 10 percent of these 60 plans would decline from current levels.

Figure 2 shows the level of contributions required for our sample of 60 plans by current law, and by the various components of the proposed legislation using the ERISA Rule as the base. The current law increased total funding in our sample of plans by about 8 percent. The proposed rules would have much larger effects.

Figure 2: Proposed Rules Will Increase Contributions In Underfunded Plans



NOTE: Based on a GAO sample of 60 underfunded pension plans (in 1990)

The Deficit Reduction Rule could be more effective than current law in accelerating plan funding improvements. This rule would almost double the total contributions for these plans. Moreover, the Cash Flow Rule would more than quadruple contributions. The proposal that plans make contributions equal to the highest of the three funding rules would require contributions of more than four times the total ERISA contribution.

While the proposed legislation would help improve funding in many underfunded plans by requiring additional contributions, it is important to note that the new rules could substantially increase required contributions for many plan sponsors. This would appear especially true for sponsors who would be subject to the new Cash Flow Rule.

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Mr. Chairman, this concludes my statement. I will be happy to answer any questions you or other Subcommittee members may have.

APPENDIX

This appendix contains a brief discussion of GAO's sample of underfunded plans, the current Internal Revenue Code Section 412(l) provisions, and proposed funding rule changes contained in S.105 and H.R.298.

GAO's SAMPLE

In 1990, over 15,000 of the plans PBGC insured were paying the variable rate premium. This premium is required of all plans that are underfunded when plan liabilities are calculated using an interest rate equal to 80 percent of the 30-year U.S. Treasury Bond interest rate. We used this population of underfunded plans to draw a random sample of underfunded plans for our study of the Internal Revenue Code Section 412(l) provisions requiring sponsors of underfunded plans to make additional contributions to their plans. Plans with fewer than 101 participants are not subject to the 412(l) provisions. More than 10,000 plans making variable rate premium payments to PBGC had fewer than 101 participants and were exempt from making additional contributions. We eliminated these plans from our base population before drawing our sample.

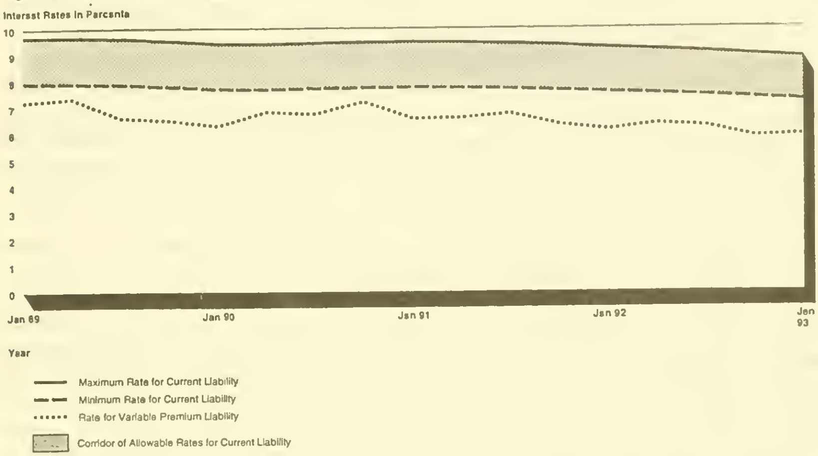
Our sample contained 93 plans for which we were able to obtain complete 1990 Form 5500 data. Although all 93 plans were underfunded for premium payment purposes, only 60 were underfunded on a current liability basis, the basis used for determining the additional contribution obligation under the 412(l) provisions. The reason 33 plans were not underfunded on a current liability basis is that current liabilities are calculated using an interest rate from an allowable corridor of rates. These rates have been higher than the interest rate used to calculate premium liabilities since the 412(l) provisions became effective (see fig. A). The uses of higher interest rates to calculate plan liabilities lowers the value of the liability. Thus, many plans that are underfunded on a premium basis may not be underfunded on a current liability basis and may not be subject to the 412(l) provisions.

THE CURRENT ADDITIONAL CONTRIBUTION PROVISION

The 412(l) provisions specify that plans that are underfunded on a current liability basis should make an additional contribution in certain circumstances. These underfunded plans are allowed to separate their current level of underfunding into two components--old and new. Old unfunded liabilities are equal to the unamortized amount of the underfunding existing in the plan at the beginning of the 1988 plan year. Old unfunded liabilities are amortized over an 18-year period beginning in 1989. New unfunded liabilities are the difference between the current level of underfunding and the old unfunded liabilities. The payment for the new component varies from 14 to 30 percent of the new unfunded liabilities and depends on the funding ratio of the plan (old and new underfunding combined.) These two payments are combined into the deficit reduction contribution.

The deficit reduction contribution is reduced for offsetting credits--amortization payments the sponsor is making for initial plan underfunding, past benefit increases, waivers, and alternative minimum funding standard payments less amortization credits for benefit changes. A charge for any unpredictable contingent event (shutdown) payments being made is added to the new total. The final additional contribution can be no larger that the level of underfunding in the plan. Plans with fewer than 150 participants pay a reduced additional contribution--2 percent of the calculated additional contribution for each participant over 100.

Figura A: Interest Rates Used to Calculate Current Liabilities (from Corridor) and Variable Premium Liabilities



NEW FUNDING PROPOSALS

Two bills (S.105 and H.R.298) have been introduced recently and would improve funding in most plans underfunded on a current liability basis. These bills would require sponsors of underfunded plans to make minimum contributions equal to the highest of the contributions required under the 412(b) rule, a modified 412(l) rule, or a proposed 412(o) rule.

The 412(b) rule requires contributions equal to the plan's normal cost plus amortization charges, less amortization credits. This is the contribution requirement under ERISA and is the current contribution requirement without the additional contribution provision. We call this the ERISA Rule.

The proposed modified 412(l) provision specifies that the current liability be calculated using a restricted corridor of allowable interest rates and that this alternative required contribution equal a payment based on the combined unfunded old and new liabilities, the plan's normal cost, amortization payments for waivers granted, and a charge for unpredictable contingent event payments. The modified 412(l) provision also eliminates the offsetting credits for certain amortization charges already being made by the plan's sponsor. We call this the Deficit Reduction Rule.

The proposed 412(o) provision would require a contribution equal to plan expenditures (including benefit payments), interest on the plan's underfunding, the plan's normal cost, and amortization payments for waivers granted. We call this the Cash Flow Rule.

Chairman PICKLE. Thank you very much, Mr. Delfico, for a very helpful, factual statement.

Now, Mr. Blum.

STATEMENT OF JAMES L. BLUM, DEPUTY DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. BLUM. Thank you, Mr. Chairman. I appreciate the opportunity to discuss the current premium structure for the Pension Benefit Guaranty Corporation and various options for improving the structure. With your permission, I will submit my prepared statement for the record and confine my remarks to a brief summary of it.

The PBGC's premium structure is important for two related reasons: it affects the behavior of insured firms as well as the income for the Corporation. The premium serves as the price for the insurance coverage. If the price is set too high, firms with fully funded pension plans will have a strong incentive to leave the insurance pool. If the price is set too low, the potential losses for PBGC will increase by encouraging firms to take too much risk with their pension plans.

The Congress initially fixed the PBGC premium at a flat annual rate of $1 per participant. Since then, through a series of amendments to ERISA, the Congress has increased the flat rate annual premium to $19 per participant and has added a variable rate premium which is now set at $9 for every $1,000 of pension plan underfunding per participant per year. The variable rate premium is capped at $53 per participant, so the total annual premium maximum is $72 per plan participant.

In 1992, the PBGC single-employer premium brought in about $875 million. The flat premium raised about 70 percent of this total, and the variable premium the remaining 30 percent. Of the income from the variable premium, about 60 percent, or $160 million, came from plans at the cap and 40 percent from plans paying some variable rate below the $53 per participant cap.

Table 1 on page 8 of my prepared statement provides some information on the distribution of premium payers. The current premium structure is independent of the dollar value of the insurance to pension plans. It is adjusted only for part of the risk of underfunding, and it ignores both the changes that a firm will fail and the riskiness of the investments that are in the pension plan's assets. So it is quite probable that the current premium structure underprices the value of the insurance for some high-risk firms and overprices the value for low-risk plans. Firms paying the overpriced premiums are subsidizing the labor costs of firms paying the underpriced premiums.

According to some analysts, this form of subsidization is the intended and appropriate goal of Federal pension insurance. Such pricing has the advantage of deferring and possibly avoiding failure of some troubled firms. A disadvantage, however, is that low-risk firms have an incentive to terminate their defined benefit pension plan and leave the insurance pool. Although no definitive evidence exists that adverse selection has occurred in the PBGC insurance pool because of the current pricing, a movement away from defined benefit plans does seem to be taking place.

In addition, by not charging firms for the risks they take, firms may be encouraged to take too much risk with their pension plans. This is particularly true for firms who are at the variable rate cap. Because of this cap, firms with the greatest underfunding face no increase in cost as underfunding increases. Consequently, some firms may use their available cash to fund nonpension-related activities. By giving firms that underfund a good deal on pension insurance, the underpriced premium could increase the exposure of the PBGC and ultimately the magnitude of claims on the insurance program.

At the request of the subcommittee, CBO has estimated the effects on PBGC income of several specific increases to the current premium structure. Table 2 of my prepared statement, which is on page 10, provides a summary of these estimates.

I must point out to you, Mr. Chairman, however, that these estimates are based on the current funding requirements under ERISA, and they could change if combined with changes in funding requirements such as those contemplated in the bill that you introduced, H.R. 298. Essentially, higher funding requirements could mean some reduction in the estimates presented in table 2.

The first option shown in the table is an increase in the flat premium from $19 to $22 per participant. This would raise about $480 million over the next 5 years. That is an increase of roughly 10 percent in the total value of premium income over that time period. An increase in the flat premium does not make the premium structure more sensitive to exposure or risk, however, and may encourage low-risk firms to leave the insurance pool, particularly if these firms believe that the Congress will continually increase the flat premium to pay for the claims of other plans.

The second option shown on table 2 is increasing the cap on the variable rate premium from $53 to $100 per participant, but keeping the variable rate at $9 per every $1,000 of underfunding. This would raise an estimated $770 million over the next 5 years. Increasing the cap would raise the price of insurance to plans with significant amounts of underfunding, but would not increase the price for other firms. Because many of the affected firms may already be in poor financial health, however, this change in the premium structure could cause some financial hardship for them.

A third option raises the variable rate from $9 per $1,000 of underfunding to $18 while holding the cap to $53 per participant. This yields only $240 million over 5 years. This change makes the premium only slightly more sensitive to exposure. It does not affect plans already at the cap.

The Congress can change more than one component of the premium structure, obviously. For example, the fourth option shown in table 2 combines all three of the previous options, an increase in both the flat and the variable rates and raising the cap on the variable rate premium to $100 per participant. This combination would raise an estimated $1.9 billion over 5 years. This would be about a 40 percent increase in the projected baseline premium revenues over this period. This premium change would target underfunded plans, but would also raise premiums of low-risk firms.

In addition, the Congress can also index the premium, or part of it, to wage growth. Because benefits may partially be a function of

wages, indexing the premium to wage growth would raise premiums as total insured benefits increased. The fifth option shown in table 2 shows the estimated revenue effect of indexing the flat premium and the variable cap applied to the premium changes made in the fourth option.

In conclusion, Mr. Chairman, the PBGC premium structure is a potentially powerful device for encouraging firms to fully fund their defined benefit pension plans and reduce the PBGC's potential losses. The present premium structure, however, does not make much use of this potential. Raising the variable rate premium and lifting the variable rate cap would make the premium structure more sensitive to the potential exposure for insurance losses.

But no premium increases are painless, I must point out. Increases in the variable rate or the variable rate cap could put some weak firms out of business. On the other hand, relying on increases in the flat rate premium could threaten the viability of the insurance system if these increases cause low-risk firms to exit the insurance program.

That concludes my summary of the statement, Mr. Chairman.

[The prepared statement and attachments follow:]

Statement of
James L. Blum
Deputy Director
Congressional Budget Office

Mr. Chairman and Members of the Subcommittee, I appreciate this opportunity to discuss the structure and effects of the insurance premiums charged by the Pension Benefit Guaranty Corporation (PBGC).

My statement focuses on four points:

- The PBGC premium has significant effects on the behavior of insured firms. Yet the current premium does not effectively discourage firms from engaging in actions--such as underfunding--that increase claims on PBGC.

- The PBGC premium also has significant effects on PBGC income. The Congressional Budget Office (CBO) estimates that PBGC's collections over five years could be raised by $240 million to $2,230 million under the increases in the premium that the Subcommittee asked us to review.

- Because of the cash treatment used to account for PBGC in the budget, some policy reforms that would enhance the financial stability of PBGC lead to a pay-as-you-go (PAYGO) charge. To avoid this outcome, the Congress could remove PBGC from the PAYGO scorecard, as has been done for deposit insurance.

- The Congress could improve PBGC pricing policy so that premiums are more likely to be adjusted and maintained at an appropriate rate in the future.

EFFECTS OF PREMIUMS ON THE INSURED AND THE INSURER

PBGC's premium is important for two related reasons: it affects the behavior of insured firms as well as the income of PBGC. These two aspects of the premium are closely related because how the premium affects firms will help determine the ability of the premium to fund the program. Moreover, the type of premium charged will determine the ability of the program to meet the objectives laid out for it by the Congress.

Relating Premiums to Expected Claims

PBGC can follow two strategies in attempting to set premiums to pay for future claims. First, it can set premiums for groups of insured plans based on risk (the probability that a claim will be made) and exposure (the potential severity of a claim). The greater the probability that the insured will make a claim and the larger the potential claim, the bigger the expected loss and the higher the premium. If insured firms pay premiums commensurate with the likelihood and size of potential claims, some firms with substantial underfunding and in weak financial condition will have to pay premiums that are much higher than they are paying now.

A disadvantage of that policy is that risk-based premiums may hasten or contribute to the failure of some firms that are now financially troubled. However, some analysts believe it is an advantage that risk- and exposure-related premiums force firms to pay the costs of the risks they impose on PBGC. They also limit the extent to which healthy firms that have funded their pension plan must subsidize others, including competitors, that have not done so. Perhaps most important, properly set premiums provide some assurance that premium income will pay for future claims.

PBGC can also use a second strategy for setting premiums: it can charge all insured plans the same premium, or premiums that would vary only slightly with risk and exposure. Such a strategy would underprice the insurance for some highly risky firms and would overprice it for less risky sponsors. Firms paying the overpriced premiums would subsidize the labor costs of firms paying the underpriced premiums. According to some analysts, this form of subsidization is the intended and appropriate goal of federal pension insurance. Such pricing strategy has the potential advantage of deferring and, possibly, avoiding the failure of some troubled firms.

A disadvantage, however, is that the strategy provides overcharged, low-risk firms with an incentive to terminate their defined-benefit plan and leave the insurance pool. If they do, it may lead to an insurance system in which only those firms with the greatest risk remain in the insured pool. In addition, by not charging firms for the risks they take, this pricing policy could have the unintended result of encouraging firms to take too much risk with their pension plans.

Departures from the insurance pool and increased risk-taking in response to a flat premium make it more likely that future costs will not be covered. This result would conflict with PBGC's legislative mandate for financing by premiums and could put enormous pressure on the Congress to provide PBGC with general fund revenues.

Historically, PBGC has followed a pricing policy much closer to the flat premium than to the risk-adjusted approach. It has always charged a flat premium; it never explicitly charged premiums based on risk and only recently added a premium component for underfunding (that is, exposure). From 1974 to 1987, PBGC charged firms only on a per-participant basis with the premium increasing from $1.00 to $8.50 during that period. Until 1988, firms that underfunded their plans paid no more in premiums than firms that fully funded their plans.

In 1987, the Congress added a premium that varies according to the underfunding of a plan. This premium was set at $6 per $1,000 of underfunding, and the flat premium was raised to $16. Because it was capped at $34 per participant, the variable premium only partially accounted for exposure. In 1991, the flat premium, the rate on the variable premium, and the cap on the variable premium were raised to $19 per participant, $9 per $1,000 of underfunding, and $53 per participant, respectively. Although PBGC may not have been able to avoid many of the claims it received, its poorly set premium contributed to its accumulated deficit of $2.7 billion. Adjusting premiums to pay for future claims does not address the difficult problem of paying for these past losses.

Because of the cap on the variable premium, firms with the greatest amounts of underfunding face no increase in costs as underfunding increases. Consequently, some firms use their available cash to fund non-pension-related activities. By giving firms that underfund a "good deal" on pension insurance, the underpriced premium could increase the exposure of PBGC and ultimately the size of PBGC claims. Estimates of a risk-related premium in a study done for PBGC indicate that the premium is vastly underpriced for high-risk sponsors of pension plans.[1]

There are three arguments against enacting risk-related premiums. First, calculating such premiums entails a high degree of uncertainty and

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1 Jack VanDerhei, "An Empirical Analysis of Risk-Related Premiums for the Pension Benefit Guaranty Corporation" (report submitted to the Pension Benefit Guaranty Corporation, 1988).

methodological complexity. However, PBGC is in the midst of a major effort to determine how characteristics of firms and plans affect future claims. Its findings should reduce--though not eliminate--the uncertainty associated with setting such premiums.

Second, some apprehension exists about having a government agency officially "rate" the financial health of private firms by setting premiums that vary according to the risk of bankruptcy. Setting a risk-related premium incorrectly could provide markets with false signals about a firm's financial health. The federal insurer could reduce these problems by using only public information, such as bond ratings, as indicators of risk.

Third, some analysts have suggested that PBGC was established to channel subsidies from stronger sponsors of plans to weaker firms. Moving to a purely risk- and exposure-related premium would sharply reduce such cross-subsidies. However, as I have discussed, a premium-financed system may not be possible over the long run if healthy firms with an option to leave the insurance pool are required to subsidize weaker firms in a significant way.

Although no definitive evidence exists that adverse selection has occurred in the PBGC insurance pool because of the current pricing, a significant movement away from defined-benefit plans has clearly taken place. For example, PBGC found that the percentage of workers with pensions, whose primary source of retirement benefits is a defined-benefit plan, declined during the 1979-1988 period from 83 percent to 66 percent. Further, because only fully funded plans can leave the insurance pool voluntarily, firms leaving the PBGC system must have a lower risk of making a claim against PBGC than the firms that remain.

<u>Effects of Premium Increases on PBGC Income</u>

Income raised by the PBGC premiums are treated as collections in the federal budget. In 1992, the PBGC single-employer premium brought in about $875 million. The flat premium raised about 70 percent of this total ($608 million) and the variable premium about 30 percent ($267 million). Of the income from the variable premium, about 60 percent ($160 million) came from plans at the cap and 40 percent ($107 million) is income from plans paying the variable premium but that are not at the cap (see Table 1 for additional information on the distribution of premium payers). When the premium is increased, the federal budget deficit is lowered; reducing the premium increases the deficit.

At the request of the Subcommittee, CBO has estimated the effects on income of several specific increases to the current premium (see Table 2 for a summary of these estimates). Because these estimates must account for changes in variables such as interest rates, they are sensitive to CBO's economic assumptions.

TABLE 1. DISTRIBUTION OF PREMIUM PAYERS (In percent)

	Plans	Participants
Plans Paying Flat Premium Only	68	73
Plans Paying Variable Rate Premium but Not at Cap	23	17
Plans Paying Cap	9	10
Total	100	100

SOURCE: CBO estimates developed using data from the 1988 filings of IRS Form 5500.

TABLE 2. PRELIMINARY CBO COST ESTIMATE OF PBGC PREMIUM OPTIONS (Outlays by fiscal year, in millions of dollars)

	1994	1995	1996	1997	1998	Five-Year Total
Raise Flat Premium to $22 per Participant	-80	-100	-100	-100	-100	-480
Raise the Cap on the Variable Premium to $100	-110	-150	-160	-170	-180	-770
Raise the Rate on the Variable Premium to $18 per $1,000 of Underfunding	-40	-50	-50	-50	-50	-240
Raise the Flat Premium to $22 per Participant, the Variable Rate to $18, and the Cap to $100 per Participant	-300	-380	-400	-410	-410	-1,900
Above Option with Flat Premium and Cap Indexed to Wages	-300	-410	-460	-510	-550	-2,230

SOURCE: CBO estimates developed using data of the 1988 filings of IRS Form 5500.

Raise the Flat Premium

Raising the flat premium from $19 to $22 per participant would raise about $480 million over the next five years. But an increase in the flat premium does not make the premium more sensitive to exposure or risk. Firms would neither pay a higher premium if they underfund their plans nor if they pose a greater risk of making a claim against PBGC. As the flat premium raises the charge on all firms, it may increase premiums above the benefits some firms receive from pension insurance. After this increase, these low-risk firms would have more reason to exit the pension insurance system than they do today.

As a result of its small size, however, a $3 per-participant increase alone would probably not drive many firms from the pool. But expected future premiums as well as current premium increases can cause adverse selection. If low-risk sponsors of fully funded pension plans believe that the Congress will continually increase their premiums to pay for the claims of other plans, they may leave the pool to avoid future increases. Some of the exiting of firms may take place in hidden ways, such as the use of temporary employees that are not covered by the firm's defined-benefit pension plan.

Increase the Cap on the Variable Premium

Increasing the cap on the variable premium from $53 to $100, while keeping the rate on the variable premium at its current amount of $9 per $1,000 of underfunding, would raise $770 million over five years. By increasing the cap, the change would target those plans with significant amounts of underfunding. Such plans, with a higher cap, would pay a higher cost for continued underfunding. Because it does not affect the flat premium, this change does not increase PBGC's vulnerability to the exit of low-risk firms. However, because the increase would target sponsors of plans that may already be in poor financial health, it could cause hardships for some affected firms--possibly even driving them out of business.

Raise the Rate on the Variable Premium

Raising the rate on the variable premium from $9 per $1,000 of underfunding to $18 per $1,000 of underfunding, while holding the cap on the variable premium at $53, would yield $240 million over five years. One reason that doubling the rate on the variable premium brings in such a relatively small amount of money is that many of the firms sponsoring plans with underfunding are already at the cap on the variable premium. Thus, raising the rate on the variable premium alone does not raise the cost of underfunding to these firms and, in general, only makes the premium slightly more sensitive to exposure. Raising the rate on the variable premium, however, is significantly more efficient than raising the flat premium since it targets those plans and the underfunding that determines the ultimate size of the PBGC claim. This targeting of the premium toward plans with underfunding may cause hardship to some pension sponsors that are already in financial difficulty.

Raise the Flat Premium, the Rate on the Variable Premium, and the Cap on the Variable Premium

The Congress can change more than one component of the premium. For example, the flat premium could be raised to $22 per participant, the rate on

the variable premium could be doubled, and the cap on the variable premium could be raised to $100 per participant. Such a change would raise $1,900 million over five years. This premium change would target underfunded plans but would also raise the fees of low-risk firms. It is impossible to link the premium to a single variable and expect it to charge the majority of insured firms correctly.

Index the Premium to Wage Growth

The Congress can index the premium, or part of it, to the growth in a firm's wages. Because benefits may partially be a function of wages, indexing the premium to wage growth would raise premiums as total insured benefits increased. Indexing the flat premium and the cap on the variable premium will raise an additional $300 million to $400 million over five years. For example, an additional $330 billion could be raised by indexing the flat premium and the cap on the variable premium while raising the flat premium to $22 per participant, doubling the rate on the variable, and raising the cap on the variable premium to $100 per participant. Indexing the cap and the rate on the variable premium could make the PBGC premium more sensitive to exposure. By itself, however, this change could not make the premium sensitive to risk and does not distinguish plans by the exposure they pose to PBGC. For example, such automatic increases would occur whether or not the new insured benefits were funded.

No premium increase is painless. Increases in the variable premium or the cap on the variable premium could put weak firms out of business. Such an outcome would result from the vulnerability of the firms to any cost increases; nonetheless, bankruptcy associated with a premium increase will strike some as undesirable and unfair. Another option would be to increase the flat premium for all sponsors of defined-benefit plans. But too high an increase in the flat premium could threaten the viability of the insurance system as low-risk plans exit the system.

PBGC AND PAYGO

Cash accounting in the budget in conjunction with the pay-as-you-go budget rule, which requires that increases in mandatory spending or decreases in revenue be offset, "penalizes" the Congress when it legislates new policies to reduce risk to PBGC. PAYGO was part of the Budget Enforcement Act of 1990. Under its rules, legislated increases in mandatory spending or decreases in revenue collections must be offset, in total, by legislated revenue increases or spending cuts. If, in any Congressional session, the total legislated changes in mandatory spending or receipts increase the deficit for that year, a pay-as-you-go sequestration is triggered. This sequestration would make up the resulting shortfall through automatic spending reductions in a limited number of mandatory programs.

PAYGO has an effect on PBGC reform because of proposed legislation that would reduce PBGC's future losses, in part, by tightening the funding rules for pension plans. The contributions of firms to pension funds are tax deductible, and funds in defined-benefit pension plans receive favorable tax-deferred status. The greater the funding of pension plans, the lower are PBGC's expected losses but the larger is the short-term tax loss to the federal government. If the Congress passes new funding rules that increase pension plan funding, the PAYGO system would record a charge.

As a result, the PAYGO system penalizes the Congress for taking action to enhance the financial stability of pension termination insurance.

This anomalous outcome results because the cash accounting treatment of the budget recognizes the tax loss immediately but ignores lower PBGC claims in the future. To avoid this result, CBO has previously recommended that the Congress be "held harmless" in the budget for adopting policies to control the cost of pension insurance. This could be achieved by changing the budgetary treatment of PBGC or more simply by exempting PBGC from PAYGO.[2]

IMPROVING PBGC PREMIUM SETTING

Insured firms are constantly adjusting their behavior as economic conditions change. In turn, these shifts mean that PBGC's potential losses are subject to significant change. If PBGC is to continue to be financed through premiums, the potential changes in future claims require that premiums be modified with corresponding flexibility. Currently, only legislation can adjust PBGC's premiums. Congressional action is required even if the needed adjustment is simply to change the insurance premiums paid by a few sponsors.

At its best, the Congress is not institutionally suited to such a managerial role. However, as noted in earlier CBO testimonies before this Subcommittee, the Congress is particularly hamstrung with this program, since the budget--one of the most important instruments for informing and motivating Congressional action--misstates the financial condition of PBGC. In fact, Congressional changes in the PBGC premium have come only after PBGC has accumulated significant, irrevocable losses. For example, PBGC reports that four years elapsed between the time it requested an increase--from $2.60 to $8.50--in the insurance premium and the time Congress enacted the increase in 1986. By then, even $8.50 would not sufficiently cover PBGC's projected losses.

One option to make it more likely that premiums are adjusted in a timely fashion is to allow PBGC--because of the data it collects on pension plans and its expertise in pension insurance--to set and adjust premiums in a timely and appropriate manner. If PBGC were given the power to make such adjustments in premiums, the Congress could retain substantial control by defining the objectives for premium pricing. For example, the Congress could instruct PBGC to establish risk- and exposure-related premiums and maintain them at rates appropriate to expected losses. The Congress would also be free to subsidize firms whose premiums would increase under such a system. Moreover, given PBGC's history of managerial, accounting, and information-system problems, the Congress may wish to establish an oversight board or in some manner provide for external review of premiums.

The Congress could also index the various components of premiums to wage growth. Although indexing does not adjust for risk and exposure, it could be an effective supplement to reforming the premium. Finally, the budgetary treatment of PBGC could be modified to give the Congress more timely, action-forcing information on the financial condition of PBGC. A number of budgetary reforms for PBGC are discussed in CBO's recent study on controlling PBGC's losses.

For a full discussion of this and other budgetary reforms for PBGC, see Congressional Budget Office, Controlling Losses of the Pension Benefit Guaranty Corporation (January 1993).

CONCLUSIONS

The PBGC premium is a potentially powerful device for encouraging firms to fund their plans fully and reduce PBGC losses. However, the premium as currently structured does not make much use of this potential. Several options are available to the Congress that would make the premium more sensitive to risk and exposure and make it more likely that the premium will be maintained at adequate levels.

Chairman PICKLE. I thank you, Mr. Blum, and I thank you, Mr. Delfico. I don't have a lot of questions. I want to personally thank both of you and your organizations for the information you have given us today. It is factual and it is timely, and I believe basically the facts you presented and the options you have outlined are inescapable for this committee and the Congress as we face the solution to this problem.

I regret to say that the 1987 law didn't provide the answers to all of the minimum funding requirements. Mr. Delfico, you pointed out that the credit offset defeats our purpose in that area. Perhaps we can make some changes in that area.

I was particularly impressed, Mr. Blum, with the options you have given us. While you don't recommend any one, it is very clear which one raises the questions and which one is really more fair to the well-funded plans and that attempts to penalize the underfunded plans so that they will pay their bills. I think these options are very viable, and I think we should close some of the loopholes and move forward in this area.

Mr. Delfico, you mentioned some of the legislation that has been introduced. You mentioned two bills in particular. In general, would you say that the measures that this committee has recommended, that I have introduced as chairman of the committee, is a good option or an option for us to follow?

Mr. DELFICO. I think it is a credible option to follow. Yes, I do.

Chairman PICKLE. Do you have any other suggestions other than the factual statements you have made?

Mr. DELFICO. At this stage of our analysis, our suggestion would be to deal with the offset problem, and I think your legislation does that.

Chairman PICKLE. Yes. We hope it will.

Now, Mr. Blum, I want to thank you because you are our arm, so to speak, and the analysis and facts you have given us I think are beyond dispute, and I think we ought to pay close attention to what you have submitted to us.

Let me ask Mr. Herger if he has any questions at this point. Mr. Herger?

Mr. HERGER. I thank you, Mr. Chairman. I really don't have any questions. I appreciate the work you are doing. I think it is quite clear that we have some major changes that we need to move towards as soon as we can, and I appreciate your input.

Thank you. Thank you, Mr. Chairman.

Chairman PICKLE. Do either of you have any additional statement to make—just 1 minute. The staff has asked me to ask one additional question of you, Mr. Delfico.

Are plan sponsors complying with the current law?

Mr. DELFICO. We are not sure, about 10 percent of them. We found in our sample that a number of them hadn't filled out a section of the 5500 form, and as we looked into it, about half of those plan sponsors that should have made a contribution did not. We are going to be dealing with IRS on this particular aspect of it.

Chairman PICKLE. Well, let me make this statement in connection to that. You are saying only about 10 percent. That is a shocking amount.

Mr. DELFICO. I didn't want to imply that only——

Chairman PICKLE. I thought you were going to say to some extent, but 10 percent——

Mr. DELFICO. That is a large amount, yes.

Chairman PICKLE. Yes, that is very large. And I am told that out of the 60 plans that GAO audited who have been required to make additional contributions, 11 did not calculate and report their required contributions under the 1987 minimum funding provisions.

Mr. DELFICO. That is correct. Eleven of the plans did not.

Chairman PICKLE. And of the 11, you calculated that 6 should have made additional contributions; thus, there appears to be a 20 percent noncompliance rate. Now, that is 6 out of 27 plans. You said 10 percent, somewhere between 6 and 10 percent.

Mr. DELFICO. Yes, depending on the error rate in there, but it is a large portion. I would just like to take a minute to say that the difficulty in finding these plans is enormous. We had to go through a hard copy of the submitted 5500 forms. The database is virtually unavailable to do that now, and I think that is going to be a big stumbling block to any enforcement efforts in the future.

Chairman PICKLE. Well, that statement is shocking and sobering, and we must take that information and swallow it and do something about it.

Mr. DELFICO. We will be working on it.

Chairman PICKLE. And I hope the committee can do that.

Now, Mr. Brewster or Mr. Herger, do you have any additional questions for either one of these gentlemen? Mr. Brewster?

Mr. BREWSTER. Mr. Chairman, a couple of questions here for CBO.

What changes could be considered to make the premium system better reflect PBGC's cost and risk, including changes to the level of premium rates and caps?

Mr. BLUM. I outlined, Mr. Brewster, in my prepared statement as well as my oral remarks, a number of options that are available to the Congress on changing the premium structure. Essentially, the premium structure now consists of three principal components: a flat rate, which is $19 per participant; a variable rate for firms that have underfunding in their pension plans, and that variable rates amounts to $9 per $1,000 of underfunding; and the third component is a cap on that variable rate, which is set or limited to $53 per participant. So that the total premium per participant for any underfunded plan is a maximum of $72.

Now, the choices available to the Congress are to change the flat rate, change the variable rate, or raise the cap. To the extent that you raise the cap, you really are targeting in on those plans that present the greatest risk to the PBGC. Similarly, raising the variable rate makes it more costly to firms that are underfunding their present plan.

Raising the flat rate essentially targets all the plans—the high-risk, the underfunded plans, as well as the low-risk, those plans that are already overfunded, if you will.

The problem with raising or relying exclusively on a flat rate premium is that you run the risk of driving those low-risk firms with overfunded plans out of the insurance pool, thereby concentrating the pool more and more on the high-risk plans.

Mr. BREWSTER. Which certainly would create some additional problems.

What about indexing premium rates?

Mr. BLUM. That is a possibility as well, and the rationale for doing that is that pension plan benefits can be said to be a function of wage levels, and as those wages grow, one would expect the pension benefits to grow as well.

Mr. BREWSTER. One more question that I asked the previous panel a moment ago. Do you know of any reason why we should not pass legislation, such as the chairman has and that I am sure you are very aware of, that says no company can increase promised future benefits unless they are at least 90 percent funded?

Mr. BLUM. I think you and the chairman made a very persuasive case this morning for taking action on an early basis.

Mr. BREWSTER. Do you think that there will be any change as far as funding is concerned without legislation to require that?

Mr. BLUM. I think without any changes in the law, the problem is only going to get worse.

Mr. BREWSTER. Thank you very much.

Chairman PICKLE. I think on that note is a good time to conclude this hearing. We appreciate your frankness and your honesty and the factual and timely manner in which you have given us this information.

I thank both of you again. Unless there are any other questions by the committee members, this committee will stand adjourned.

[Whereupon, at 12:12 p.m., the subcommittee was adjourned.]

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